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No. 82-

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1982

CAPITOL INDUSTRIES-EMI, INC.,
Petitioner,

vs.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., Successor; KENNETH COBY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether Section 1341, Title 28, United States Code, removes from the federal court's jurisdiction a suit to enjoin and restrain the assessment and collection of a California Franchise tax, where it is not "plain" that the complainant has any judicial remedies available to it in the California courts to contest the amount of the tax or even to raise constitutional issues.

2. May the State of California burden foreign commerce by extending the combined unitary income formula (hereinafter "combined formula") which it applies to an American corporation to include the income, property and wages of its United Kingdom parent corporation and the latter's 71 non-U.S. subsidiaries operating worldwide, which have foreign commerce with the United States but which do no business in any state of the United States, which do not have a permanent establishment in the United States, which are not subject to taxation by the United States Government under either the Internal Revenue Code or the United States-United Kingdom Income Tax Convention, and where the effect of the State's application of its formula is to apportion some of the income of the nonresident United Kingdom corporation and its non-United States subsidiaries to the American subsidiary for taxation by California where:

(a) The income of the United Kingdom corporation and of its non-U.S. subsidiaries which is included in the combined unit California would apportion, has already been taxed by the United Kingdom and the other host countries, and California allows neither a deduction for those taxes nor a credit for them against its own tax, thus producing multiple taxation of income earned in foreign commerce; and

(b) The income of petitioner, the American subsidiary, is swollen by the apportionment to it of some of the income of the United Kingdom parent and its non-U.S. subsidiaries, far beyond any conceivable earning capacity of the American subsidiary from the conduct of its own business; and

(c) The apportionment of the combined net income by the three-factor formula of the ratio of California property, payroll and sales to the combined world-wide property, payroll and sales of the United Kingdom parent and its seventy-six subsidiaries, is made on the basis of estimates, first because the Official Secrets Act of the United Kingdom prohibits the United Kingdom corporations from revealing some of the information essential to the application of the California formula, and second because the wages paid by the non-U.K. subsidiaries are not reported to the United Kingdom parent and are for years before California made its demand and cannot now be assembled; and

(d) There is no uniformity between the economic environment in which the American subsidiary operates and those in which the non-U.S. corporations operate, most notably because the wage rates in the United States for the years before the Court are higher than those which prevail in the countries in which the corporations which California would consolidate operate, with the result that each factor in the formula is weighted to apportion more net income to California than could be earned in that state by the business conducted in it, such income being therefore derived from that properly taxable by the United Kingdom and the

other foreign countries where the businesses are conducted; and

(e) where the businesses of the United Kingdom parent, its non-U.S. subsidiaries, and the American subsidiary which are being combined consist primarily of the recording in each country of music popular in and often peculiar to that country, the making of records and tapes in the country in which the recording was made, and the sale of those records and tapes to the residents of that country, but sales of records in foreign commerce are made by both the U.K. parent and petitioner, the American subsidiary, to customers of their choice, and under a reciprocal matrix exchange agreement both the U.K. parent and the American subsidiary make records of music initially recorded by the other; and

(f) where the effect of the California formula is to tax to petitioner, the American subsidiary, income earned and received exclusively abroad by other corporations from business conducted locally in other countries or in foreign commerce, which income California would not have jurisdiction over directly because of the Due Process Clause, of International Law, of the United States-United Kingdom Income Tax Convention, and of Section 381, Title 15, United States Code.

3. Is California's use of the combined formula in the circumstances contrary to the Due Process clause, the United States-United Kingdom Income Tax Convention then in effect, and International Law?

PARTIES TO THE PROCEEDINGS BELOW

There is no other party to this proceeding. EMI Limited is a party to a companion but unconsolidated case which the Court of Appeals remanded to the District Court for further proceedings. On October 8, 1982, the District Court dismissed the EMI case. An appeal will be but has not yet been filed, and a petition for certiorari will be but has not yet been filed.

EMI Limited stock is owned in the United Kingdom.

Petitioner has no partially owned subsidiaries.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Capitol Industries-EMI, Inc., a Delaware corporation, petitions for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, to review its decision rendered February 16, 1982, petition for rehearing denied and opinion amended July 22, 1982. A second petition for rehearing was filed on July 27, 1982 and denied on September 7, 1982.

OPINIONS BELOW

The opinion of the Court of Appeals was released for publication on July 22, 1982, and is reported at 681 F.2d 1107. It is reproduced in Appendix A, attached hereto. The District Court filed an opinion, which is unpublished. It is set forth in Appendix B.

JURISDICTION

The jurisdiction of this Court is invoked under Section 1254(1) of Title 28, United States Code.

The jurisdiction of the federal court was invoked under Sections 1331 and 2201, Title 28, United States Code. Petitioner contends that it does not have a plain, speedy and efficient judicial remedy available to it in the California courts, and for that reason the provisions of Section 1341, Title 28, United States Code, do not remove this case from the jurisdiction of the federal courts.

STATUTES, CONSTITUTIONAL PROVISIONS AND TREATIES INVOLVED

1. The sections of the Judicial Code involved are Sections 1331, 1341 and 2201, Title 28, United States Code. They are set forth verbatim in Appendix C.

2. The sections of the United States Constitution involved are the Commerce Clause (Art. I, Sec. 8, cl. 3), the Due Process Clause (Amendment 14, Sec. 1), the Import-Export Clause (Art. I, Sec. 10, cl. 2), and Art. I, Sec. 8, cl. 1 and 10, and Art. I, Sec. 10, cl. 1 and 3; and Art. II, Sec. 2, cl. 1 and 2, Art. III, Sec. 2, cl. 1 and 2, and Sec. 3, cl. 1 and 2, and Art. VI, cl. 2 and 17. All are set forth in Appendix D.

3. The United States-United Kingdom Income Tax Convention in effect in the years involved in this case. The text of the relevant provisions is set forth in full in Appendix E.

4. Section 381 of Title 15, United States Code, is also involved. Its text is set forth in Appendix F.

STATEMENT OF THE CASE

This case is one to restrain defendant tax officials of the State of California from assessing a tax against plaintiff, Capitol Industries-EMI, Inc., on a portion of the income of its parent, EMI Limited, and the latter's 71 non-US subsidiaries from their business not done in the United States but done exclusively in foreign and local commerce from and in the United Kingdom and other foreign countries, in violation of the United States Constitution, and a federal statute, of a United States treaty, and of International Law.

Petitioner Capitol Industries-EMI, Inc., is a Delaware corporation, and is a subsidiary of EMI Limited, a corporation of the United Kingdom. That corporation owns all or substantially all of the stock of 76 subsidiary corporations, some of which are formed under the laws of the United Kingdom, and others of which are formed under the laws of the various countries in which they operate. They operate in and are formed under the laws of more than 30 countries in Western Europe, North America, the Near East and the Far East of Asia, South America, Africa, and Australasia. Capitol Industries-EMI, Inc. (hereinafter "Capitol"), is one such subsidiary, and has been since EMI Limited acquired a majority of its stock in 1956. Capitol has its principal office and plant in Holly-

wood, California, and has other plants in Illinois, Virginia and Connecticut.

Capitol makes and sells phonograph records and pre-recorded tapes of music recorded in its studios and in independent studios by artists under contract to it. These artists are selected by Capitol, and the music recorded is selected by Capitol, or by Capitol and the artists. EMI has no role in Capitol's selections of artist or music. Capitol sells its records nationally and internationally, through outlets with whom it establishes contractual relationship. Its sales are to the trade. It also has its own licensees in foreign countries who make and sell records in their countries from Capitol matrices. EMI Limited does not direct or participate in any of these activities and arrangements.

EMI Limited does not do business in the United States and does not have a permanent establishment in this country. It is therefore not subject to United States tax by treaty and international custom. In its corporate self it does no business outside of the United Kingdom. EMI's worldwide subsidiaries make approximately 20% of all of the phonograph records made in the Western world and own pressing plants located in 13 countries. Capitol in the United States owns three of these plants. In addition to that type of music business, through subsidiaries operating in several countries, but not in the United States, the EMI group is in the business of retailing phonograph records and pre-recorded tapes, and sheet music.

Subsidiaries of EMI also operate a variety of other businesses: the manufacture of television cameras, antennae and transmission equipment, and of security devices; the operation of a movie studio at which both television

films and films for the theater are made; the operation of movie theaters, bingo parlors, hotels, restaurants, and places of amusement; the manufacture for the government of the United Kingdom and certain governments of NATO of military equipment, much of which employs radar principles pioneered and in some instances invented by EMI, and the development and production of equipment in the field of medical electronics, the most notable of which is the invention and patenting of the brain scanner and body scanner. Capitol conducts no business other than the making of phonograph records and pre-recorded tapes, and at times the manufacture and sale of raw tape for use by other recording companies.

EMI does operate in foreign commerce between the United Kingdom and the United States. Its subsidiaries sell completed phonograph records to an unrelated United States outlet, but not to Capitol. It and its subsidiaries have a matrix exchange agreement with Capitol, modeled closely after the one which EMI Limited had with RCA before EMI acquired controlling interest in Capitol, under which each party has an option to license a duplicate matrix of recordings made by the other, to make recordings of the music embedded on that matrix and to sell them in their marketing areas. This agreement is entirely reciprocal, giving EMI precisely the same rights in respect to matrices of music recorded by Capitol as it gives Capitol for matrices made by EMI. The agreement confers an option right on each party, and does not bind either party to take any of the matrix offerings of the other. The license fees and other amounts paid for the privilege are entirely reciprocal, so that the amounts paid by Capitol to EMI are the same as the amounts paid by EMI to Capitol, per unit manufactured.

Both EMI and Capitol contend that they are not engaged together in a single unitary business, and that the income of each can be readily ascertained by the arm's length method used by the United States Government under Section 482 of the Internal Revenue Code, and by all foreign governments. They also contend that taxing Capitol on an apportioned amount of EMI's income represents a forbidden burden on foreign commerce and denial of due process, contrary to the Constitution of the United States, and contrary to International law, to the United States-United Kingdom Income Tax Convention, and to Section 381, Title 15, United States Code.

Defendants initiated their audit of Capitol's returns by demanding information of EMI Limited, threatening it with monetary penalties if it did not reply.[1] EMI informed them that it was not within the jurisdiction of California, could not supply some of the information sought because of restrictions of the Official Secrets Act of the United Kingdom, and did not possess other of the information sought because it was not supplied to EMI by EMI's non-U.K. subsidiaries. Defendants then made the same request for information of Capitol, with the same threat of a penalty, and Capitol informed defendants that it could not supply information about EMI which it could not get from EMI. Defendants' employees then compiled figures about EMI available from public sources in the United States, and assessed a proposed additional tax against Capitol based upon what they believed to be the

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[1]The Court of Appeals stated in a footnote that the demand was made only on Capitol. The court's remark is contrary to three affidavits in the record and is not supported by any affidavit or other evidence.

total net income of EMI and all of its worldwide subsidiaries, and an apportionment of it to California based upon the ratio which the California property, payroll and sales of Capitol bore to what defendants estimated was the total worldwide property, payroll and sales of EMI and its subsidiaries. The non-U.K., non-U.S. property and payroll figures were unknown and defendants substituted their estimates. Capitol protested this action, conferences were held by Capitol representatives with defendants and their representatives, and those representatives informed Capitol that defendants would adhere to their position, until such time as Capitol provided the information defendants had sought from EMI. EMI Limited, and Capitol Industries-EMI, Inc., both then filed cases in the United States District Court for the Northern District of California against the defendants, to restrain such an assessment against Capitol, and in EMI's case to restrain defendants from lessening the value of EMI's investment in the United States, through the assertion of unconstitutional taxes from Capitol, from burdening EMI's foreign commerce with the United States, and for other relief.

Cross-motions for summary judgment were filed, in petitioner's motion supported by extensive affidavits of officers of EMI and Capitol, and documentary exhibits. While these cases were pending, defendants' representatives proposed to Capitol's representatives that defendants would change the basis of assessment, to combine Capitol only with EMI's music business. Capitol's representatives informed defendants' representatives that the information they needed for such a modified combination and apportionment was not available, so the representatives of defendants devised figures based upon assumptions and estimates and em-

ployed those in the apportionment formula in substitution for the figures that they had previously used, which had been their estimate of the entire worldwide business of EMI Limited. The effect was to reduce the deficiency, but a deficiency in excess of $400,000 still remains in issue for the years determined by defendants, and an unknown but certain amount for later years. On December 7, 1981, while this case was submitted and awaiting decision in the Court of Appeals, defendants mailed notices of final assessment so computed. Petitioner has obtained a stay of collection by filing an appeal with the State Board of Equalization.

The District Court rendered summary judgment for defendants, holding that petitioner had an adequate remedy in the California courts. Appeal was taken, and the Court of Appeals also held that petitioner had a "plain, speedy and efficient" remedy in the state courts, and remanded the case for dismissal. The merits were not considered.

REASONS FOR GRANTING THE WRIT

1. This Court should grant the writ in order to declare that it has not held that § 1341, Title 28, U.S. Code, renders § 1331 and § 2201 of the same title dead letters in state tax cases. The court below seems to think otherwise, because it has construed this Court's prior decisions as dispensing with the statutory requirement that the state court remedy, to be a disqualifying one for federal jurisdiction, must be "plain". This Court has held that the efficiency of the state remedy must be "plain", in two decisions it has not overruled, *Atlantic Coast Line R. Co. v. Daughton;* 262 U.S. 413, 426 (1923); *Hillsborough Township v. Cromwell,* 326 U.S. 620, 625 (1946). The decision below is in conflict with them. It is "plain" that the California state

court remedy is questionable, at best. The precise limits of judicially created doctrines are always difficult to predict and the California doctrine of exhaustion of administrative remedies as a condition precedent to relief in the courts is a judicially established doctrine, without statutory foundation indicating what its limits are. The California courts have been steadily expanding the doctrine, and it has been applied in two tax cases in the California courts in a manner which raises the most serious question about whether petitioner would have an "efficient" remedy in those courts.

Petitioner has been unable to supply some of the information demanded by defendants' staff, and defendants accordingly made estimates and assessed tax based on them. The information sought was about sales, property and payroll of EMI and its non-United Kingdom subsidiaries from the music business and EMI could not supply petitioner with that information, party because some of that information was about its foreign subsidiaries, who did not classify it, and party because the British Official Secrets Act forbade it. At least the latter bar may be removed with time, but under California doctrine information subsequently available could not be used at the trial. Effectively this would prevent petitioner's challenging the computation and under a recent state decision the earlier failure to supply is a fatal jurisdictional bar to any relief, even on constitutional grounds.

In *West Publishing Co. v. McColgan*, 27 Cal.2d 705, 166 P.2d 861, 865 (1946) affirmed on other grounds, 328 U.S. 823, the California Supreme Court held that evidence which the taxpayer had not presented to the administrative agencies could not be introduced in court in a refund action challenging the administrative conduct. The result was to

prevent the taxpayer from questioning the amount of the assessed tax, though the court did proceed to consider the taxpayer's constitutional arguments. More recently, however, in *Barnes v. State Board of Equalization*, 118 Cal. App.3d 904, 173 Cal.Rptr. 742 (1981), hearing denied, the California Court of Appeal even refused to permit the taxpayer to present its constitutional points. The reason was the same as in *West*, that the taxpayer had neglected to supply information requested by the State Board of Equalization while the case was in the administrative process.

The Court of Appeals below has construed both cases in its opinion in a manner which limits them severely, and the court was apparently under the impression that it had the power to instruct the California courts how to interpret their own precedents. Unfortunately for this petitioner, however, the California courts are at liberty to define the doctrine of exhaustion of administrative remedies according to their own concepts, and are not bound by the interpretation of a federal court. The Court of Appeals erred in believing that it could define the state doctrine in a way which would govern the state courts in a later proceeding involving this petitioner.

The Court of Appeals could not deny that the two California cases did hold that evidence not presented to the administrative agency could not be presented later in court, or that the *Barnes* case held that the requirement was jurisdictional and prevented the court from considering any of the taxpayer's arguments on the merits, even constitutional arguments which were unrelated to the facts not presented. The Court of Appeals stated that those decisions would not apply to a taxpayer such as Capitol which failed

to introduce evidence for the administrative agencies which it had no power to obtain and offer, and speculated that if Capitol succeeded in obtaining further information from EMI, at a subsequent date, it could then successfully offer that information or evidence in a state court action. There is, unfortunately, not a whit of suggestion in the *Barnes* opinion that that view is correct. Furthermore, it would have to depend upon whether the California courts agreed that EMI had properly construed the Official Secrets Act of Great Britain. The administrative agency denied that it had. This is a subject which should not properly be presented for consideration by state courts, yet under the view taken by the Court of Appeals of what the California courts meant to hold, it would be of the essence that they decide that Capitol was indeed unable because of British law to introduce or offer the evidence the Franchise Tax Board had requested, and which Capitol sought to introduce at a later date in the state court proceedings.

The record in this case contains several pamphlets in which EMI describes in some detail the role it plays as a defense contractor for the United Kingdom Government, and in a general way the products which it supplies to that government. That revelation was first made by the British Government, and EMI could not have made it until permitted to do so. The future may also bring a relaxation of certain specific prohibitions in the same regard, as the years in question fall further into history and the materials supplied in those years become more obsolete. It might well come to pass that Capitol would be able to supply all the information the Franchise Tax Board requested for its "music-only" formula by the time the case comes to trial in the California courts, but it seems anything but "plain"

that the California courts would permit Capitol to argue its constitutional points or to introduce the newly obtained evidence. That evidence would relate only to amount of tax, of course, but the same is true of the evidence the taxpayer tardily sought to offer in the *Barnes* case, and yet it was held precluded from having its unrelated constitutional arguments considered.

Section 1341 is being stretched in the decision below beyond the limit of permissible interpretation, and this Court should review the decision for the purpose of informing the lower courts that § 1341 is not a restriction absolute in all cases, but only when the state courts do provide a "plain, speedy and efficient" remedy.

A decision from this Court that state courts so restricting their remedy do not remove federal jurisdiction is needed to show the federal courts that § 1341 is not a dead letter, and at the same time it will not open the floodgates because the unusual facts here presented should not find many parallels. Indeed, it would probably serve as a warning to the state courts that they should not create bars to state relief which prevent the remedies they offer from being "efficient."

2.A. This Court has accepted jurisdiction of two cases[3] presenting constitutional issues raised by the application of their combined apportionment formulae by American states to foreign source income of foreign subsidiaries of domestic parent corporations. This case presents another, and vitally important aspect of the same problem: viz, the application of such combined apportionment formulae to

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[3]*Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*, Illinois Department of Revenue, No. 81-349, Oct. Term 1982; *Container Corporation of America v. Calif. Franchise Tax Board*, No. 81-523, Oct. Term 1982.

the foreign source income of a foreign parent corporation with an American subsidiary. This aspect of the problem should, if possible, be considered while the Court is considering the other cases.[3] Considerations unique where there is a foreign parent, such as treaties, double taxation of the before-tax income, and the fact the foreign source income of foreign parents will never be paid into the United States, and will never be within the reach of the United States, are considerations the Court should have presented to it on plenary argument, and will not have before it in cases involving American parent corporations. As the Solicitor General pointed out in his amicus brief in *Chicago Bridge & Iron Co. v. Caterpillar*, supra footnote 3, it is the instance of the taxation of the American subsidiary so as to reach the income of the foreign parent which has the international community up in arms. This case is that case, and presents this Court with its only present vehicle for ruling on it directly.

B. The Court has learned from the briefs of the parties and amici curiae in both *Chicago Bridge & Iron* and *Container Corporation* that there is no more serious international controversy involving the United States in the area of taxation than that which has been engendered by the insistence of certain states on applying their combined unitary apportionment formulae to foreign parent corporations and their foreign subsidiaries, and then combining

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[3]Petitioner's companion case, *EMI Limited v. Bennett* et al., formerly in this Court as No. 81-1088, is back in the District Court on remand. The challenge to jurisdiction under § 1341 was rejected in the Court of Appeals, but it ordered, sua sponte, that EMI's standing to sue be examined. A motion to dismiss on that ground was granted and an order of dismissal entered on October 8, 1982. An appeal and a petition for certiorari will both be filed.

them with their American subsidiaries. The protest letters of the President of the European Economic Community, The Netherlands, Canada and others have been presented to the Court, as have the voices of various foreign trade associations.

C. The international community has shown much more concern with the avoidance of duplication of income taxes than it has with the duplication of property taxes. There are presently 40 such treaties, either in effect between the United States and foreign countries c.. .gned and in the process of ratification. The concern this Court expressed in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), about duplication of taxation in foreign commerce and the retaliatory effect that could be expected from permitting a state to impose taxes on foreign commerce which duplicate the tax burden imposed by the home nation, should be even greater here. The duplication of income taxation in the international sphere is an issue repeatedly dealt with in treaties, and international custom of avoiding it has developed even where there are not bilateral treaties. As we will show hereafter, the retaliation which this Court foresaw would follow from the duplication of tax involved in *Japan Line*, if this Court had permitted it to occur, has already occurred in the international income tax sphere. This case is an excellent vehicle for the consideration of the impact of this type of combined formula because the feared duplication of tax exists in fact, and the ultimate equity owner of the income which has been taxed twice is a foreign corporation, formed under the laws of and operating in a treaty nation, and having no permanent establishment in the United States. The impact of any decision in this area involving domestically-owned multinational corporate

groups cannot be fully assessed by this Court without consideration of the possible impact of such a decision on foreign parents of multinational groups which have one or more subsidiaries operating in the United States.

D. In *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), this Court held that the constitutional tests of validity of taxes in foreign commerce differed from those in interstate commerce. Our Nation's formative history explains the necessity of that conclusion, and of the corollary the Court also adopted, that schemes of taxation which do not impermissibly burden interstate commerce may impermissibly burden foreign commerce. Hence apportionment methods valid in taxation of interstate commerce may be invalid when applied to foreign commerce, and this Court's decision in *Japan Line* held that the apportionment of property values there involved, though valid in interstate commerce, was invalid in foreign commerce.

The history we referred to suggests strongly that the prohibition against states' burdening foreign commerce is absolute. Two eminent historians state that the two principal causes of the American Revolution were dissatisfaction with Parliament's control over taxes and over foreign commerce. The first governing law over the United States, the Articles of Confederation, did not substitute another central control over these subjects for the one the Continental Congress was fighting to terminate. 3 Farrand, *The Records of the Federal Convention of 1787* (1911), pp. 547-548; 2 Curtis, *History of the Constitution of the United States* (Harper and Brothers, 1854), pp. 20-22; 1 Curtis, *History etc.*, p. 148. Experience with operating under the Articles soon demonstrated that the Union would not survive long in peacetime if each state remained

free to contribute to the national treasury only whatever it chose, to regulate and to tax foreign commerce, and to make its own treaties of trade with foreign nations. 1 Curtis, History etc., 179-180, 202-213, 276-277; The Federalist XII (Alexander Hamilton). The necessity of removing from the states all control over foreign commerce in order to preserve the Union was perceived, and was a major factor in framing the Constitution, and in gaining adherents to it. The Federalist XLIV (John Jay); The Federalist XI (James Madison); 2 Curtis, History etc., pp. 11-12, 13-14 (footnotes), 23-24. 3 Farrand, *The Records of the Federal Convention of 1787* (1911), Appendix A, CCCCI, 539, 547-548; *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 283 (1976). There was not equal perception that the Congress should also have the power to regulate interstate commerce, but that subject was vigorously debated and the power was conferred only after the persuasion of debate. 2 Curtis, History etc., pp. 289-298. Thus history shows that the Constitutional Convention was absolutely disinclined to tolerate state interference with foreign commerce, and was less concerned wih state interference with interstate commerce.

It follows that the absence of Congressional legislation specifically laying down standards may imply some tolerance of state interference with interstate commerce, but none with foreign commerce.

For this reason, this Court should review the application of State formulae taxing the foreign source income of foreign parent corporations and their subsidiaries to domestic subsidiaries of the foreign parents. This case, where the cleavage between income earned in this country and that earned abroad is unusually distinct, is an appropriate vehicle.

E. The action defendants would take is in violation of the treaty then in effect. The treaty treated laws of the states as laws of the United States and restricted their application to foreign corporations not having a permanent establishment in the United States. Although Capitol is not a direct beneficiary of the treaty, Capitol is the direct victim of its disregard. In view of the obvious reluctance of the federal courts to permit EMI to enforce its own rights, and the unavailability to EMI of any access to the state courts, the treaty rights can apparently be effectively enforced only by Capitol.

F. International law prohibits what defendants seek to do, this Court should so declare, and in this case can do so. In *Japan Line*, the property subjected to multiple taxation had nexus with California through actual physical presence. Here there is an entire absence of nexus. EMI Limited has not property of its own or office in California. Use of the arm's length standard is international custom, and the combined unitary formula is not. Under International law ownership of the stock of Capitol does not establish the presence of EMI in every State in which Capitol operates. International law is based on custom and settled practice as much as on treaties and agreements. *The Paquete Habana*, 175 U.S. 677, 686, 708 (1900); *Sears v. The Scotia* 14 Wall (81 U.S.) 170 (1872); *McCulloch v. Marineros de Honduras*, 372 U.S. 10, 21 (1963); *Statute of the International Court of Justice*, Article 38 (1); *Statute of the World Court*, Article 36. Every state is subordinate to International law. *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 425 (1964). The international custom to respect the distinction between foreign parent and domestically formed subsidiary is so thoroughly accepted that it is in

each of the forty income tax treaties the United States has signed and in addition is universally respected between nations where there is no treaty. Thus, for example, Mexico and the United States, and Colombia, Venezuela, Peru, Chile and Spain and the United States all bilaterally recognize the custom in the absence of treaty.

The official position of the Executive about what is prevailing international custom binds the American courts (Draft *Restatement of Foreign Relations Law (Revised)*, American Law Institute, Sec. 132 (3)). The Solicitor General, in response to requests from the Secretaries of State, Treasury and Commerce, and the United States Trade Representative, has informed this Court that the Executive recognizes that international custom mandates the use of the arm's-length method and not the combined unitary formula. He has asked this Court to rule that the international custom should be enforced by this Court. Memorandum for the United States as Amicus Curiae, filed in *Chicago Bridge & Iron Company v. Caterpillar Tractor Co.*, et al., No. 81-349, October Term 1981.

Petitioner has fully discussed the existence of this international custom and its status as international law in the Amicus Brief it filed in concert with its parent, EMI Limited, in the pending case of Container Corporation of America v. Franchise Tax Board, No. 81-523, October Term, 1982, pp. 5-21. Reference to that brief can be made for a full development of the status of this custom as international law.

The importance of this Court's early review of California's departure from International law, in conjunction with the cases it is reviewing, justifies the Court's review of this case.

G. In *Japan Line, Ltd. v. County of Los Angeles*, supra, this Court predicted that foreign governments would be driven to retaliate against the United States if American states were permitted to impose a duplicating tax on property already, and properly, taxed in the home country. California's tax practices typified by what defendants are seeking to do here have already produced retaliation by the United Kingdom. The new U.S.-U.K. Income Tax Convention as signed, and approved by the British Parliament, contained an express prohibition of California's combined formula as applied to United Kingdom parents and their American subsidiaries. The United States Senate approved the treaty except for that provision, which narrowly failed to obtain two-thirds approval. This required that the British Parliament ratify the treaty without that provision, which for two years it refused to do. It insisted on another revision, the Third Protocol, which had the effect of permitting increases in the taxation of American corporations operating in the British North Sea. This was an "additional concession to the British" for "loss of the benefits of Article 9(4)" (the prohibition of State unitary taxation) according to Assistant Secretary Donald Lubick. (Appendix G.) This retaliation is not confined to California's corporations.

There is no assurance other countries will not also retaliate against the California combined formula. There are nine members of the EEC who joined in repeated denunciation of the California practice. Since one has already retaliated, it is reasonable to expect others to do so. Certainly the danger this Court foresaw if the States are free to impose multiple tax burdens on foreign commerce is present here, and this Court should review the permissibility of the California method as soon as possible.

This case provides a suitable vehicle.

H. Independent of Constitutional limitations on the state's power to tax, Defendants are seeking to do by indirection what Congress has forbidden them to do directly. Title 15 United States Code, Section 381. Subsections (a) and (c) of that Code section prescribe the nexus necessary for a state to tax income derived from interstate commerce, and should be applied to prevent a state from importing income from a related foreign entity and subjecting it to tax, where the corporation properly subject to its tax is a self-sufficient and independently operating business entity from the foreign concern.

I. The issue is not precluded by *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271, (1924), which involved a single British corporation doing business in two American states. It could not have claimed protection under the treaty or 15 U.S. Code Sec. 381, neither of which was yet in effect, nor under International custom, which had not yet evolved. Its business was clearly unitary, consisting of making a product in Great Britain and selling it through offices in Illinois and New York, but it offered no evidence of a loss in New York yet claimed one because it showed a loss from its New York and Illinois business combined in its federal tax return. It had clearly submitted itself to the state's jurisdiction, unlike EMI. No subterfuge to reach an exempt corporation was involved.

J. The action of defendants is in conflict with the Due Process Clause, under the recent decisions of this Court in *ASARCO Inc. v. Idaho State Tax Commission*, No. 80-215, October term, 1981, decided June 29, 1982, ... U.S. ....., 73 L.Ed. 2d 787, and in *F. W. Woolworth Co. v. Taxation & Rev. Dept.*, No. 80-175, October term, 1981 decided

June 29, 1982, ... U.S. ....., 73 L.Ed. 2d 819. Under the tests enunciated in those two decisions, the business of petitioner is not unitary with that of its parent corporation, EMI Limited, and particularly not with that of the non-United Kingdom subsidiaries of EMI, which defendants would consolidate with Capitol. We recognize that the Court is unlikely to believe that it should review this case in order to determine the proper application of its two recent decisions where they have not been considered below, or by the California tax authorities for that matter, but we believe that if the Court does grant certiorari it may wish to preserve this issue as one possibly to consider.

CONCLUSION

This case represents the ideal vehicle for this Court's consideration of the constitutional status, under the United States Constitution and International Law, of the combined unitary formula used by California and certain other states, in the application where a domestic subsidiary is combined with a group of foreign corporations, including the parent corporation, who do not have permanent establishments in the United States, and a mathematically determined percentage of the total income of the group is assigned to the domestic subsidiary for taxation. This is done here without regard to the absence of any over-reaching or other conduct which could have the effect of improperly shifting income from the subsidiary to the foreign sources, and the fact any irregularities could be adequately dealt with by the internationally accepted arm's-length method. This case would expand the scope of this Court's consideration of the *Container Corporation of America v. Franchise Tax Board*, No. 81-523, to include a domestic subsidiary of a foreign parent, and thus provide the Court with a vehicle

suitable for considering fully the objections of the foreign nations to California's departure from established international custom, and California's double taxation of income already fully taxed in the host or parent country.

We believe the procedural objection the Court of Appeals found should not deter the Court, because it is plainly based on a serious fallacy, which fallacy is that the Federal Courts can tell the California courts how to interpret to their own judicially created doctrines of exhaustion of administrative remedies. The evidence provided by the State courts is what must be considered, and that evidence shows that those courts are expanding the doctrine and would probably prevent petitioner from having a full trial, with all issues considered, including both those of constitutional law and of fact, in a manner to satisfy the requirements of due process for a trial de novo. There is, therefore, not a "plain, . . . efficient" remedy in the State courts, and the Federal courts have not been ousted of jurisdiction by Section 1341. Since the facts of this case are unusual, agreement with our position on this point will not open the floodgates in California cases. Moreover, it might well cause the California courts to rethink their judicially erected barriers to "efficient remedy".

Accordingly, the Writ of Certiorari should be granted.

Respectfully submitted,

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Attorneys for Petitioner

(Appendices follow)

Appendix A

CAPITOL INDUSTRIES-EMI, INC.,
Plaintiff-Appellant,

v.

William M. BENNETT, Kenneth Cory, Richard Silberman, individually and as members of, and Martin Huff, individually, and as Executive Officer of, the Franchise Tax Board, State of California, Defendants-Appellees.

EMI LIMITED, Plaintiff-Appellant,

v.

William M. BENNETT, Kenneth Cory, Richard Silberman, individually and as members of, and Martin Huff, individually and as Executive Officer of, the Franchise Tax Board, State of California, Defendants-Appellees.

Nos. 80-4113, 80-4114.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted Oct. 15, 1981.
Decided Feb. 16, 1982.
As Amended July 22, 1982.

On Appeal from the United States District Court for the Northern District of California.

Before WALLACE and PREGERSON, Circuit Judges, and BYRNE,* District Judge.

WM. MATTHEW BYRNE, Jr., District Judge:

*The Honorable Wm. Matthew Byrne, Jr., United States District Judge for the Central District of California, sitting by designation.

This appeal involves two companion cases brought by an United Kingdom corporation and its United States subsidiary corporation, respectively, for injunctive and declaratory relief to prevent officials of the State of California from assessing additional income taxes against the subsidiary.

I

Appellant in the first action (No. 80-4113), Capitol Industries-EMI, Inc. ("Capitol"), is a Delaware corporation, with its principal place of business in California. Capitol is in the business of recording phonograph records and tapes for sale through commercial channels. Capitol contends that its business is conducted almost exclusively in the United States.

Appellant in the second action (No. 80-4114), EMI, Limited ("EMI"), is a United Kingdom corporation, which owns more than 70% of the stock of Capitol.[1] EMI owns a group of subsidiaries, fourteen of which operates outside of the United Kingdom. EMI, through its subsidiaries other than Capitol, is engaged in the same business as Capitol, but primarily in markets other than in the United States. In addition, EMI and its foreign subsidiaries, other than Capitol, are engaged in diversified businesses unrelated to the recording industry.

In the seven years involved in this tax dispute, 1968-1974, Capitol has paid annual income taxes in California.[2]

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[1]According to appellees, EMI owns more than 70% of the stock of Capitol. According to appellants, EMI owns more than 90% of the stock of Capitol.

[2]In the seven years involved in this dispute, Capitol has made annual self-assessed state franchise tax payments averaging $88,841.68.

Neither EMI nor its subsidiaries, other than Capitol, have filed any income tax returns with the United States or any state therein. However, EMI and its other subsidiaries have paid income taxes in their respective home countries.

The Franchise Tax Board, State of California ("FTB"), contends that California law requires a combined report of a taxpayer, including all commonly owned or controlled corporations that are engaged in a unitary business. The FTB has determined that Capitol, EMI and other EMI subsidiaries are engaged in a single business. Therefore, the FTB has proposed to assess against Capitol an additional tax liability for the seven years in question, based on the state's "unitary method" of taxation.[3] It is this proposed assessment that Capitol and EMI challenge.

Application of the unitary scheme under California law, as proposed by the FTB, involves the combining of the net incomes of Capitol, EMI, and all of EMI's other subsidiaries, related to the music portion of their businesses, and the apportioning of that combined income between Califor-

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[3]According to materials submitted by the parties subsequent to oral argument on appeal, the FTB has adjusted the proposed additional assessments against Capitol to reflect its determination that the unitary business in which Capitol and EMI are involved encompasses only the "music activities" of the "EMI group." In addition, the proposed assessments were adjusted to reflect agreements between Capitol and the FTB related to other issues not before this Court. As a result of these adjustments, the revised proposed assessments are as follows:

Year	Amount
June 30, 1968	$ 42,171
June 30, 1969	$118,948
June 30, 1970	$207,677
June 30, 1971	$ 0
June 30, 1972	$ 75,527
June 30, 1973	$ 16,827
June 30, 1974	$344,185

nia and the rest of the world, based on a formula using the California ratio of property, payroll, and sales, to the world-wide figures for the same factors.[4]

In the course of the FTB's investigation of Capitol, it has demanded that Capitol provide certain business records of EMI, and EMI's other subsidiaries, under the threat that Capitol's failure to comply would result in a penalty assessment. EMI informed Capitol that it would not provide some of the information demanded because, under the Official Secrets Act of the United Kingdom, some of the information (presumably information related to military contracts entered into by EMI and the British government) is not disclosable. EMI refused to provide other information on the grounds that it either lacked access to such information, or because it asserts that California lacks jurisdiction over EMI and its non-United States subsidiaries.

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[4]California Revenue and Taxation Code section 25101 provides in part:

> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of article 2 (commencing with section 25120 of this chapter)....

Cal.Rev. & Tax. Code § 25101. Section 25128 provides:

> All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

Cal.Rev. & Tax. Code § 25128. Sections 25129 through 25136 define and provide for the computation of the property, payroll and sales factors. Cal.Rev. & Tax. Code §§ 25129-25136.

Capitol filed a protest with the FTB concerning the proposed assessment, which is still pending.[5] In addition, Capitol has petitioned the FTB to authorize the use of a reporting scheme other than the unitary method, as applied to the proposed assessment.[6] Subsequent to oral argument on appeal, the FTB denied that petition.[7]

Capitol filed its action in United States District Court against William Bennett, Kenneth Cory, Richard Silberman and Martin Huff ("Board Members"), individually and as members of the FTB.[8] Capitol seeks injunctive and

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[5]Section 25864 of the Revenue and Taxation Code provides:

> Within 60 days after mailing of each notice of additional tax proposed to be assessed the taxpayer may file with the Franchise Tax Board a written protest against the proposed additional tax, specifying in the protest the grounds upon which it is based.

Cal.Rev. & Tax. Code § 25864.

[6]Section 25137 of the Revenue and Taxation Code provides:

> If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> a. Separate accounting;
>
> b. The exclusion of any one or more of the factors;
>
> c. The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
>
> d. The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

[7]Appellees submitted a copy of the Board's resolution, dated October 21, 1981, denying Capitol's Section 25137 petition challenging the subject proposed additional assessment.

[8]Subsequent to oral argument on appeal, appellants filed a Motion for Designation of Substituted Parties, pursuant to Federal Rule of Civil Procedure 25(d). Under Federal Rule of Appellate Procedure 43(c), the substitution of public officials who have succeeded

declaratory relief to prevent the proposed assessment. Essentially, Capitol argues that unitary treatment of its business and that of EMI and other EMI subsidiaries is inappropriate under California law and violates the Foreign Commerce Clause of the United States Constitution, Art. I, Sec. 8, Clause 3.[9]

EMI filed its action in federal court against the identical defendants and asserts essentially the same claims as Capitol.[10] Additionally, EMI alleges that the proposed assessment on its subsidiary Capitol would negatively affect its stock holdings in Capitol. Both EMI and Capitol also seek relief from the FTB's demand that Capitol provide certain records of EMI and its foreign subsidiaries.

The Board Members filed motions to dismiss both actions. Capitol and EMI then filed motions for summary judgment. The district court treated the Board Members' motions as motions for summary judgment, pursuant to Federal Rule of Civil Procedure 56. The district court

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those named as parties occurs automatically. An order of substitution is unnecessary under Rule 43(c) but such an order may be entered at anytime thereunder. Upon the representations of appellants as to the present membership of the FTB and upon the non-opposition of appellees to the motion for designation of substitution, this Court hereby orders that Mary Ann Graves, Ernest J. Dronnenburg, Jr., and Gerald H. Goldberg, be substituted for Richard Silberman, William M. Bennett, and Martin Huff, as defendants-appellees in these actions, pursuant to Rule 43(c).

[9] In particular, Capitol argues that the proposed assessment is unconstitutional in view of *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 99 S.Ct. 1813, 60 L.Ed.2d 336 (1979), where the Supreme Court held that the Commerce Clause of the United States Constitution prohibited a state from imposing a nondiscriminatory *ad valorem* tax on foreign-owned instrumentalities engaged solely in international commerce.

[10] *See* note 8 *supra*.

denied Capitol's and EMI's motions and granted the Board Members' motions on the ground that the Anti-Injunction Act precluded subject matter jurisdiction because a "plain, speedy and efficient" state court remedy existed for the claims asserted by Capitol and EMI. 28 U.S.C. § 1341.[11] Capitol and EMI appeal from that order.

II

Section 1341 provides that "district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under state law where a plain, speedy and efficient remedy may be had in the courts of such State." 28 U.S.C. § 1341.[12] This statute has its roots in equity practice,

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[11]Appellees also contend that the present actions are barred from being brought in federal court by the Eleventh Amendment.

A court should not pass upon a constitutional question although properly presented by the record, if there is also present a statutory ground upon which the case may be disposed of. *See, generally, Wood v. Strickland*, 420 U.S. 308, 95 S.Ct. 992, 43 L.Ed.2d 214 (1975). This principle has varied application, *id.*, and presumably applies where two grounds are presented for defeating subject matter jurisdiction. *See*, generally, 1 *Moore's Federal Practice* ¶ 0.60[3], at 620-21 (2d ed. 1980). Thus, this Court should first consider whether the district court could exercise jurisdiction notwithstanding the proscriptions of the Anti-Injunction Act. If the district court order is affirmed on this ground, this Court need not reach the constitutional question presented by the Eleventh Amendment.

[12]The legislative history of Section 1341 reflects two main purposes: First, the section was aimed at eliminating the discriminatory effect on citizens of the taxing state, who can only bring their tax disputes before state courts, while out-of-state corporations could take their disputes into either federal or state court. *See Aluminum Co. of America v. Dept. of Treasury of the St. of Mich.*, 522 F.2d 1120, 1123-24 (6th Cir. 1975); S.Rep.No. 1035, 75th Cong. 1st Sess. 1-2 (1937). Second, the section was intended to eliminate the disruption of state financing efforts by out-of-state corporations. *Id.; see Perez v. Ledesma*, 401 U.S. 82, 128 n.17, 91 S.Ct. 674, 698 n.17, 27 L.Ed.2d 701 (1971)(Brennan, J., concurring in part and dissent-

the principles of federalism, and in recognition of the need of a state to administer its own fiscal operations. *Tully v. Griffin, Inc.*, 429 U.S. 68, 73, 97 S.Ct. 219, 222, 50 L.Ed.2d 227 (1976); *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 298, 63 S.Ct. 1070, 1073, 87 L.Ed. 1407 (1943) (*"Great Lakes"*). This Court has held that Section 1341 also generally bars actions for declaratory relief against the assessment or collection of state taxes. *See Housing Authority of the City of Seattle v. State of Washington*, 629 F.2d 1307, 1310 (9th Cir. 1980);[12] *see also Great Lakes*, 319 U.S. at 300, 63 S.Ct. at 1074. The jurisdictional bar of Section 1341 is not avoided by challenging the constitutionality of the state statute that authorizes the subject assessment or collection. *Mandel v. Hutchinson*, 494 F.2d 364, 366 (9th Cir. 1974) *citing Matthews v. Rodgers*, 284 U.S. 521, 525-26, 52 S.Ct. 217, 219, 76 L.Ed. 447 (1932). The issue here is whether California affords Capitol and EMI a "plain, speedy and efficient" remedy.

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ing in part); *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 298, 63 S.Ct. 1070, 1073, 87 L.Ed. 1407 (1943) (*"Great Lakes"*).

The Congressional Record indicates two secondary reasons behind the enactment of Section 1341. First, Congress was concerned with the added expense of litigating in federal courts that might make it financially unsound for state or local taxing authorities to contest a wealthy corporation's tax liability. *See Aluminum Co. of America*, 522 F.2d at 1124, *citing* 81 Cong.Rec. 1416-17 (1937). Second, Congress intended to relieve the congestion in the federal courts by letting state courts settle what were viewed as essentially state controversies. *Id.*

[12] *Accord Aluminum Co. of America*, 522 F.2d 1120; *City of Houston v. Standard-Triumph Motor Co.*, 347 F.2d 194 (5th Cir. 1965), *cert. denied*, 382 U.S. 974, 86 S.Ct. 539, 15 L.Ed.2d 466 (1966); *Helmsley v. City of Detroit*, 320 F.2d 476, 478 (6th Cir. 1963).

III

A

We first address the state remedies available to Capitol. Under California law, a suit for an injunction, declaratory relief, or other equitable process to prevent or enjoin the assessment or collection of any taxes is forbidden. Section 32, Art. XIII, Calif. Const.; Cal.Rev. & Tax Code § 26101 (assessment or collection of corporate or bank taxes). California, however, does provide corporate taxpayers with administrative and judicial remedies for challenging assessments. The taxpayer may petition the FTB to seek authorization to use a method other than the unitary method of reporting. Cal.Rev. & Tax.Code § 25137.[14] In addition, a taxpayer that believes it has been illegally or excessively assessed may file a protest with the FTB. Cal. Rev. & Tax.Code § 25664.[15] If the protest is denied, the taxpayer may file an appeal with the California State Board of Equalization. Cal.Rev. & Tax.Code § 25667.[16]

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[14]*See* note 6 *supra*.

[15]*See* note 5 *supra*. Section 25666 of the Calif.Rev. & Tax. Code provides:

> If a protest is filed the Franchise Tax Board shall reconsider the proposed assessment, and if the taxpayer has so requested in its protest, shall grant the taxpayer, or its authorized representatives an oral hearing. After consideration of the protest and the evidence adduced in the event of such oral hearing, the Franchise Tax Board's action upon the protest is final upon the expiration of 30 days from the date when it mails notice of its action to the taxpayer unless within the 30-day period the taxpayer appeals in writing from the action of the Franchise Tax Board to the [State Board of Equalization].

[16]Section 25667 of the Cal.Rev. & Tax. Code provides:

> The appeal [from the denial by the Franchise Tax Board of the taxpayer's protest] shall be addressed and mailed to the State Board of Equalization at Sacramento, California. . . . The board shall hear and determine the appeal and forthwith notify the

Upon the disposition of such an appeal, and payment of the assessed tax, the taxpayer may bring an action in state court against the FTB for a refund. Cal.Rev. & Tax.Code § 26102.[17]

This Court has held that such administrative proceedings, followed, if necessary, by a trial *de novo* in state court, provide a taxpayer with an adequate remedy, for purposes of Section 1341. *See Mandel*, 494 F.2d at 367;[18]

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taxpayer and the Franchise Tax Board of its determination and the reasons therefor. Such determination shall be final upon the expiration of 30 days from the time of such determination unless within such 30-day period the taxpayer or the Franchise Tax Board files a petition for rehearing with said board. In that event the board's determination shall not become final until the expiration of 30 days from the time the board issues its opinion on the petition.

[17]Section 26102 of the Cal.Rev. & Tax. Code provides:

Except as provided in Section 26103a [which pertains to the statute of limitations], after payment of the tax and denial by the Franchise Tax Board of a claim for refund, any taxpayer claiming that the tax computed and assessed against it under this part is void in whole or in part may bring an action, upon the grounds set forth in its claim for refund, against the Franchise Tax Board for recovery of the whole or any part of the amount paid.

[18]In *Mandel* v. *Hutchinson*, this Court also discussed the availability to a taxpayer of a writ of mandate "if there is no adequate remedy at law." 494 F.2d 364, 367 (9th Cir. 1974). The Court recognized, however, that the California Supreme Court has generally refused to grant a writ of mandate because of the adequacy of the State's refund procedure at law. *Id.* The Court concluded in *Mandel* that the California state court "remedies are 'plain, speedy and efficient,'."

In referring to "remedies", it is not clear whether the Court was referring to the alternative refund actions available to the appellant with respect to the particular type of tax involved in that case, or whether the Court was referring to the alternative refund actions, as well as, the possibility of a mandamus action. In any event, there is no indication that the Court in *Mandel* sought to modify the holding of *Aronoff* that a refund action in state court, by itself, generally is an effective remedy, within the meaning of section 1341.

Aronoff v. Franchise Tax Board of the State of California, 348 F.2d 9, 11 (9th Cir. 1965) ("it has consistently been held, without a single instance of deviation that the refund action provided by California Personal Income Tax law is a 'plain, speedy and efficient remedy' such as to invoke the restraints of [section] 1341");[19] *see also Harsh California*

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[19]Capitol urges this Court to reconsider its holding in *Aronoff*, in light of *Tully v. Griffin, Inc.*, 429 U.S. 68, 73, 97 S.Ct. 219, 222, 50 L.Ed.2d 227 (1976). In *Tully*, the Supreme Court held that the taxpayers had an adequate remedy under a New York statute that provided for a declaratory action. Capitol contends that this holding, coupled with the Supreme Court's omission of any discussion of New York's post-payment remedies, indicates that the Court considers only pre-payment procedures as adequate remedies, within the meaning of Section 1341. (This argument assumes, of course, that a postpayment remedy was available to the particular taxpayer in *Tully* and that the issue was raised in that case).

The holding in *Tully* neither mandates nor intimates that the Ninth Circuit must abandon its rule, which appears consistent with prior Supreme Court decisions, that a refund action in state court provides a taxpayer with an adequate remedy. *See Great Lakes*, 319 U.S. at 298, 63 S.Ct. at 1073 (federal courts in equity will deny relief to the taxpayer "especially where the state . . . has set up its own adequate procedure for securing to the taxpayer the recovery of an illegally exacted tax"); *Matthews v. Rodgers*, 284 U.S. 521, 526, 52 S.Ct. 217; 220, 76 L.Ed. 447 (1932) (payment of tax under protest and suit for recovery saves taxpayer his federal rights and defeats the federal court's jurisdiction to enjoin collection). The holding of *Aronoff* is also consistent with the express legislative intent of Section 1341, not to interfere with state assessment and collection of taxes, *see* pp. 1113-1115 and note 16 *supra*, and the law of other circuits. *See Non-resident Taxpayers Ass. v. Municipality of Philadelphia*, 478 F.2d 456, 458 (3d Cir. 1973) (Pennsylvania refund suit provided adequate remedy); *Helmsley*, 320 F.2d 476 (Michigan refund action); *see also Houston*, 347 F.2d at 199 (Texas implied action for refund may constitute an adequate remedy).

Capitol argues that postpayment actions are inherently less speedy than prepayment actions, Section 1341, however, does not mandate the "speediest" remedy in order to preclude subject matter jurisdiction in federal district court. To the extent that a postpayment ac-

Corp. v. County of San Bernardino, 262 F.2d 626 (9th Cir. 1958); *Adams County v. Northwestern Pacific Railway Co.*, 115 F.2d 768, 775 (9th Cir. 1940) (ordinarily, an injunction in federal court is unavailable where the exclusive remedy is an action for refund).[20]

Capitol argues, however, that the application of the doctrine of exhaustion of administrative remedies renders its state remedies far less "speedy and efficient" than a declaratory or injunctive action in federal court.

It is unclear to what extent a taxpayer must exhaust its administrative remedies before bringing a refund action in California state court. A taxpayer can expedite the state proceedings by paying the proposed tax, filing a claim for

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tion is less speedy than a prepayment action, a point not conceded by appellees, a taxpayer's interest in having the speediest remedy possible is outweighed by the burden that prepayment actions might impose on a state's administration of its taxation system.

[20]A state refund action, however, does not constitute an adequate remedy in all situations. "Special circumstances" may render such an action "of doubtful efficiency," in which case jurisdiction in federal court is not excluded. *Adams County*, 115 F.2d 768, 775 (9th Cir. 1940) (refund action not an adequate remedy where subdivision's ability to pay refund was uncertain), *citing Atlantic Coast Line v. Daughton Commissioner*, 262 U.S. 413, 43 S.Ct. 620, 67 L.Ed. 1051 (1923); *see Georgia Railroad & Banking Co. v. Redwine*, 342 U.S. 299, 72 S.Ct. 321, 96 L.Ed. 335 (1952) (refund suit did not provide adequate remedy where only partial refund was obtainable); *see generally Hillsborough Township v. Cromwell*, 326 U.S. 620, 66 S.Ct. 445, 451, 90 L.Ed. 358 (1943) ("exceptional circumstances" can take a case outside the general rule of federal noninterference with state taxation). The inability of the taxpayer to pay a proposed assessment may constitute such a "special circumstance." *See Denton v. City of Carrollton*, 235 F.2d 481, 485 (5th Cir. 1956) (assessment may pose such a heavy burden that to deny equitable relief is to deny judicial review). Capitol does not assert, nor is there any indication in the record, that it is unable to pay the proposed assessment here.

refund, and then, after six months, filing a suit for refund in state court. Cal.Rev. & Tax.Code §§ 26073-26076. Capitol argues, however, that the failure to exhaust administrative remedies may limit the issues and evidence that can be presented in a state court action.

The jurisdictional bar of Section 1341 is not avoided where a state prescribes resort to administrative remedies before state court review. *See George F. Alger Co. v. Peck*, 347 U.S. 984, 74 S.Ct. 605, 98 L.Ed. 1120 (1954). Thus, even assuming that Capitol must exhaust its state administrative remedies to be assured of an effective adjudication in state court, the imposition of such a requirement does not necessarily render the state remedies inadequate for purposes of the Anti-Injunction Act. Although exhaustion of administrative remedies may result in a less speedy adjudication, it is also possible that the taxpayer may emerge victorious without the necessity of judicial action or that certain issues may be resolved prior to judicial action.[21] *See, e.g., People v. West Publishing Co.*, 35 Cal.2d 80, 216 P.2d

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[21]In the present case, for example, upon consideration of Capitol's Section 25137 petition, the FTB modified its proposed assessment to reflect its determination to only unitize the music portion of Capitol's and EMI's businesses.

Appellees contend that the determination to unitize only the music portion of appellants' business moots "a substantial portion of appellants' case." The removal of non-music business from the proposed assessment may moot some sub-issues and affect the ultimate determination on the merits. The primary issues in these actions, however, are not mooted by the FTB's modification: whether unitary treatment of *any* of the appellants' businesses is appropriate under California law, and, if so, whether such treatment is permissible under the federal Constitution. Inasmuch as these cases are before this Court on the issue of subject matter jurisdiction, rather than on the merits, the Board's determination as to the exclusion of non-music business does not alter the posture of these cases on appeal.

441 (1950) (exhaustion of administrative remedies affords Board the opportunity to rectify mistake in tax collection); *Barnes v. State Board of Equalization*, 118 Cal.App. 3d 994, 173 Cal.Rptr. 742 (1981). In any event, the rule is not one of comparative remedies: "For a state remedy to be 'adequate' under [section 1341] it need not necessarily be 'the best available or even equal to or better than the remedy which might be available in the federal courts' ". *Mandel*, 494 F.2d at 367; *quoting Bland v. McHann*, 463 F.2d 21, 29 (5th Cir. 1972), *cert. denied*, 410 U.S. 966, 93 S.Ct. 1438, 35 L.Ed.2d 700 (1973).

Capitol further argues that the unavailability of certain EMI business records renders the available state remedies ineffective. Capitol contends that it cannot force its parent, EMI, to provide documents necessary for Capitol to carry its burden before the FTB, the State Board of Equalization, or the state court, of establishing that the proposed assessment is inaccurate or illegal.[22] Capitol argues that the lower state court will be limited to the evidence that is submitted to the administrative agencies. Therefore, if such records become available later, Capital argues that it would be unable to present them in the state court.

Even assuming that records that might become available subsequent to the administrative proceedings would be precluded in a *de novo* trial in state court, this would not ren-

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[22]The Supreme Court has held, for example, that where a taxpayer is asserting that the application of a particular assessment formula to a particular taxpayer violates its rights to due process, the burden is on the taxpayer to show that the apportionment is "out of all appropriate proportion to the business transacted" in the state. *Hans Rees' Sons, Inc. v. State of North Carolina*, 283 U.S. 123, 135, 51 S.Ct. 385, 389, 75 L.Ed. 879 (1930) (application of single-factor formula in assessment of state tax).

der Capitol's state remedies inadequate.[23] It is unclear how much evidence is unavailable to Capitol and how relevant it is to the issue of the correct amount of the subject assessment.[24] Moreover, it is mere speculation that any additional EMI records will be made available during the pendency of state administrative and judicial proceedings. Most important, Capitol's asserted problem is not unique in kind, though it may differ in degree, from that faced by many taxpayers in suits challenging a proposed assessment; it may not have available all of the information necessary to carry its burden of establishing that the pro-

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[23]Capitol relies primarily on *West Publishing Co. v. McColgan*, 27 Cal.2d 705, 166 P.2d 861 (1946), *aff'd*, 328 U.S. 823, 66 S.Ct. 1378, 90 L.Ed. 1603 (1946). In *West*, the taxpayer offered no evidence as to the correct amount of the subject tax during administrative proceedings. Rather, the taxpayer challenged the subject tax without regards as to amount. The taxpayer then attempted to introduce such evidence in the subsequent refund suit. The California Supreme Court held that the taxpayer was precluded from introducing such evidence as to the issue of the amount of the assessment because it had failed to provide such evidence to the relevant agencies. The Court concluded that had such evidence been presented to the administrative agencies below, the alleged inaccuracies could have been corrected then. *Id.*

It does not necessarily follow from *West* and *Barnes* that the California courts would prevent a taxpayer from presenting newly available evidence in a refund suit, where the correct amount of the subject assessment was raised before the FTB and the taxpayer provided the Board with the relevant documents within its control.

[24]The FTB's "Resolution Denying the Section 25137 Petition of [Capitol]," *see* note 3 *supra*, states that "[t]he Official Secrets Act of the United Kingdom would not appear to preclude the submission of payroll and property factors attributable to the music activities of the organization." The FTB went on to conclude that "[i]n the absence of specific information as to the total property and payroll of the unitary business of which [Capitol], is a member, the determination of such factors by the department was appropriate and reasonable."

posed assessment is inappropriate. Even if Capitol were afforded an immediate trial in federal court, presumably, the same records would still be unavailable.[25]

Finally, Capitol argues that its remedy in state court is inadequate because it is uncertain whether the state courts can consider constitutional challenges to the proposed tax assessment. A state remedy is adequate only where it is certain that the taxpayer can raise constitutional claims in the state court. *See Tully*, 429 U.S. at 73, 97 S.Ct. at 222 (federal district court is under equitable duty to refrain from interfering with a state's collection except where "an asserted federal right might otherwise be lost"); *cf. Atlantic Coast Line*, 262 U.S. 413, 43 S.Ct. 620, 67 L.Ed. 1051 (state remedy inadequate where there was uncertainty as to state court's limitations on such a remedy).

The California Constitution prevents a state administrative agency from passing on constitutional questions. Art. 3, Sec. 3.5.[26] Capitol suggests that because constitutional ques-

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[25]Capitol appears to argue that if it cannot carry its burden before the state agencies because of the unavailability of certain EMI records, as a matter of state or constitutional law, such unavailability of records renders the subject assessment illegal. The California courts are capable of addressing that issue and any other issues related to such records.

[26]Section 3.5 provides:

> An administrative agency, including an administrative agency created by the Constitution or an initiative statute, has no power:
>
> (a) To declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional;
>
> (b) To declare a statute unconstitutional;
>
> (c) To declare a statute unenforceable or to refuse to enforce a statute on the basis that federal law or federal regulations

tions cannot be determined by the FTB or State Board of Equalization, the state court will not pass on such questions in a subsequent court action.

Although there is little case law interpreting Section 3.5, it is clear that the section does not preclude a taxpayer from raising constitutional claims in subsequent judicial actions. *See, e.g., Japan Lines, Ltd. v. County of Los Angeles,* 441 U.S. 434, 99 S.Ct. 1813, 60 L.Ed.2d 336 (1979) (California Superior Court ruled on the constitutionality of *ad valorem* tax application in refund action); *cf. Fenske v. Public Employment Retirement System (P.E.R.S.) Board of Administration,* 103 Cal.App.3d 590, 163 Cal. Rptr. 182 (1980) (Section 3.5 does not deprive superior court of its power to declare unconstitutional a statute governing administrative agencies); *Radtke v. Alcoholic Beverage Control Approval Board,* 491 F.Supp. 42 (C.D. Cal.1980) (Section 3.5 does not preclude state court from determining constitutional issues upon review of administrative discipline of liquor licensee).[27] Rather, Section 3.5 merely restrains administrative agencies from refusing to enforce state statutes on constitutional grounds and from declaring state statutes unconstitutional. *See Goldin v. Public Utilities Commission,* 23 Cal.3d 638, 688 n.18, 153

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prohibit the enforcement of such statute unless an appellate court has made a determination that the enforcement of such statute is prohibited by federal law or federal regulations.

Cal.Const. Art. 3, § 3.5.

[27]"The authority of California state courts to consider constitutional claims, notwithstanding Section 3.5, is indicated by the language in Section 3.5(a) & (c), "unless an appellate court has made a determination that the enforcement of such statute is unconstitutional," Section 3.5(a), or "is prohibited by federal law or federal regulations," Section 3.5(c). Generally, an appellate court will consider issues only after they have been addressed by the trial court.

Cal.Rptr. 802, 822 n.18, 592 P.2d 289, 309 n.18 (1979).[28] Therefore, constitutional challenges to tax assessments may be raised in the California courts. However, as stated above, in order to obtain state court review of constitutional challenges, a taxpayer must first exhaust its administrative remedies. Capitol argues that, under California law, its inability to provide the Board with certain evidence controlled by EMI will constitute a failure to exhaust, thus precluding state court review of the constitutional issues raised in this case.

Capitol bases this argument on *Barnes*, 118 Cal.App.3d 994, 173 Cal.Rptr. 742. In *Barnes*, the plaintiff brought a declaratory action in Superior Court alleging that the Board had wrongfully denied his claim for a refund of a tax overpayment and challenging the constitutionality of certain tax statutes and regulations. The district court granted the Board's motion for summary judgment on the ground that the plaintiff's refusal to provide the Board with documentation for his claim of overpayment constituted a failure to exhaust his administrative remedies. The granting of summary judgment was affirmed on appeal.

Barnes is clearly distinguishable from the present case. In *Barnes*, the plaintiff refused to provide the Board with evidence admittedly in his possession. As the court in *Barnes* explained, "[t]he doctrine of exhaustion . . . requires a party to use all available agency administrative

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[28] In *Goldin v. Public Utilities Commission*, the California Supreme Court stated that "Section 3.5 places restraints on administrative agencies relative to their refusal to enforce statutes on constitutional grounds; it does not affect their enforcement of their own rules or their competence to examine evidence before them in light of constitutional standards." 23 Cal.3d 638, 688 n.18, 153 Cal.Rptr. 802, 822 n.18, 592 P.2d 289, 309 n.18 (1979).

procedures for relief and to proceed to a final decision on the merits by the agency before he may resort to the courts." 118 Cal.App.3d at 1001, 173 Cal.Rptr. at 746. The purpose of the exhaustion doctrine is to give the Board "the opportunity to rectify any mistake in tax collection." *Id.* As the *Barnes* court recognized, a taxpayer could frustrate this policy if he were allowed to withhold from the Board evidence in his possession and then seek state court review.

In contrast, Capitol asserts that it cannot produce certain evidence possessed by another corporation. The exhaustion doctrine, as applied in *Barnes,* requires that the taxpayer do all he can to prevail in the administrative proceedings; it does not require that he do the impossible. If Capitol has provided the Board with all evidence within its control—a factual issue, which, under the doctrine, the Board has the first opportunity to determine—it will have "use[d] all available agency administrative procedures for relief" and, upon a "final determination on the merits" by the Board, will have exhausted its administrative remedies.

The inability to produce certain evidence may cause the taxpayer to lose in the administrative proceedings because he may be unable to carry his burden of proof. It will not, however, unlike the refusal to produce evidence, preclude judicial review of the Board's determination and of any constitutional challenges raised by the taxpayer. If it is Capitol's contention that its inability to produce evidence possessed by EMI renders the subject assessment unconstitutional, that challenge too may be raised in state court following an unfavorable ruling by the Board; however, a favorable ruling by the Board would moot that issue—

which is precisely the reason that the administrative proceedings should be allowed to run their course.

Thus, contrary to Capitol's contention, the doctrine of exhaustion under California law does not preclude the constitutional review it seeks. Therefore, Capitol has a "plain, speedy and efficient remedy" within the meaning of Section 1341.

B

The district court treated the Board Members renewed motions to dismiss as motions for summary judgment and granted the motion in Case No. 80-4113. This Court has held, however, that an order of dismissal, and not a Rule 56 motion for summary judgment, is the proper method for disposing of an action in which subject matter jurisdiction is lacking. *See O'Donnell v. Wien Air Alaska, Inc.*, 551 F.2d 1141, 1145 n.4 (9th Cir. 1977); *Jones v. Brush*, 143 F.2d 733, 735 (9th Cir. 1944). The principle underlying the rule is that the tenor of Rule 56 suggests that summary judgment thereunder deals with the merits of an action and not with matters of abatement. *O'Donnell* at 1145 n.4, *quoting* 6 J. Moore, *Moore's Federal Practice* ¶ 56.03, at 56-57 [footnote omitted] (2d ed. 1976). Lack of subject matter jurisdiction is properly a matter in abatement. *Id.* It is, therefore, error to rule on a summary judgment motion "or any other matter going to the merits" where a court determines that it lacks jurisdiction over the subject matter. *Id., citing* Moore, *supra* at 56-57 & n.8."

"It is unclear from the record on appeal on what grounds the district court treated the Board Members' motion to dismiss as one for summary judgment under Rule 56. Perhaps the court considered such treatment appropriate because it accepted and considered matters submitted outside the pleadings. However, matters outside the pleadings related to the issue of subject matter jurisdiction can be

The proper remedy is for this Court to vacate the judgment entered in Case No. 80-4113 and to remand with directions to enter judgment dismissing the action for lack of jurisdiction. *See Martucci v. Mayer*, 210 F.2d 259, 261 (3d Cir. 1954), *cited with approval in O'Donnell*, 551 F.2d at 1145 n.4; *but see Jones*, 143 F.2d at 735 (judgment *reversed* and case remanded with directions to enter judgment dismissing the action).

IV

We now turn to the question of whether EMI has an adequate state court remedy.

The administrative procedures and refund suit provided by California law are remedies available only to taxpayers. Capitol, and not EMI, is the only California taxpayer involved in this controversy. Therefore, California does not provide EMI with an administrative or judicial remedy to challenge tax assessments.

The district court, however, concluded that EMI's interests in opposing the subject assessment is "identical or substantially identical to that of [Capitol], which does have access to the state administrative agencies and state courts." Thus, the court found the appellants' interests "being identical," EMI has "in effect a plain, speedy and efficient state remedy as to the matters for which it complains." The district court therefore also granted summary judgment in favor of the Board Members and against EMI.

The claims of Capitol and EMI are substantially the same. Both seek to have the Board Members enjoined from

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considered on a motion to dismiss for lack of jurisdiction. *See* 5, C. Wright & A. Miller, *Federal Practice and Procedure* § 1350 at 549-554 (1969).

imposing the subject assessment and from demanding EMI's business records. The interests of the two corporations, however, are not necessarily identical. Although EMI contends that the proposed assessment would, in effect, constitute a tax on its non-United States business income and that of its other foreign subsidiaries, it is Capitol that would directly have to pay the assessment. Thus, while the harm that Capitol seeks to avoid is the payment of an additional assessment, EMI seeks to avoid a more indirect harm: the diminished return on and value of its stockholdings in its subsidiary corporation, Capitol.[20]

No authority has been presented for the proposition that a nontaxpayer, without state administrative or judicial remedies, is precluded under Section 1341 from maintaining an action in federal court because it has substantially similar interests and claims as a taxpayer that has such state remedies. A nontaxpayer that has stated a claim with

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[20]With respect to the EMI records demanded by the FTB, the interests of the two corporations are not identical. It is clear from the record on appeal that the demand for the subject records was addressed to Capitol and not to EMI. Capitol claims that it lacks access to the records, which it needs in order to succeed in its state administrative and judicial proceedings. EMI argues that its disclosure of some of the records would violate the Official Secrets Act of the United Kingdom, disclosure of other records is unwarranted because EMI is not within the taxing jurisdiction of California, and, if the records are not made available, it will be indirectly harmed by the additional tax assessment against its subsidiary.

In addition, EMI contends that the proposed assessment would violate the United States-United Kingdom Income Tax Convention because the effect of the assessment is to tax income earned by EMI outside of California, and that it is entitled to a federal court determination of that claim. Capitol, EMI argues, could only claim protection by the Convention as an incidental beneficiary. We do not address the issues raised with respect to the Convention, in view of our ruling as to Case No. 80-4114.

respect to an assessment or collection is entitled to a judicial remedy in which they can participate as a party. *See Builders & Developers Corp. v. Manassas Iron & Steel Co.*, 208 F.Supp. 485 (D.C.Md. 1962) (nontaxpayer could invoke federal jurisdiction where state remedy was available only to taxpayer); *see also D. C. Transit System, Inc. v. Pearson*, 149 F.Supp. 18 (D.D.C. 1957) (nontaxpayer could invoke federal jurisdiction), *rev'd*, 250 F.2d 765 (D.C. Cir.) (reversed upon reassurances that local remedies would be provided to nontaxpayer); *cf. Pool v. Walsh*, 282 F. 620 (9th Cir. 1922) (nontaxpayer had standing to enjoin collection of federal taxes); *Shelton v. Gill*, 202 F.2d 503 (4th Cir. 1953) (same).[11] Because California does not provide

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[11]EMI argues that the nontaxpayers in the above cited cases may have had a more direct interest in the proposed assessments at issue than does EMI. Such a distinction may be relevant in determining whether EMI has standing to assert a claim related to the assessment against Capitol or whether it has stated such a claim. The issue here, however, is whether a non-taxpaying entity is precluded by Section 1341 from bringing an action related to such an assessment, assuming that the entity has standing and has stated a claim.

There is serious question whether EMI, as a non-taxpayer, has standing to challenge the proposed assessment against its subsidiary corporation, Capitol, or whether it has stated a claim upon which relief can be granted. These issues, however, were not the basis for the district court's order granting summary judgment against EMI. Both issues, and any other grounds for dismissal or summary adjudication not raised on this appeal are appropriate for consideration in the first instance by the district court on remand.

The issue of standing, for example, was not raised expressly on this appeal. The issue of standing may involve factual determinations, which are appropriate for initial determination by the trial court. In addition, as a matter of judicial economy, deferring consideration of the standing issue, and any other potential grounds for dismissal of Case No. 80-4114, could be raised and determined at the same time.

Subsequent to oral argument on appeal, appellants moved for leave to file a supplemental memorandum concerning the issue of EMI's standing. We hereby deny that motion.

EMI with an effective state remedy for its claims, Section 1341 does not bar the district court from exercising subject matter jurisdiction over such claims.[32]

V

Appellees argue that if EMI's action is not precluded by Section 1341, it is barred by the Eleventh Amendment of the United States Constitution.

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[32]Allowing a parent corporation to bring an action in federal district court to challenge a state tax assessment against its subsidiary corporation could result in the circumvention of state remedial procedures that Section 1341 was intended to prevent. *See* note 12 *supra*. Moreover, simultaneous federal and state actions involving substantially similar issues clearly is not desirable. California, however, could eliminate both problems by clearly providing a judicial or administrative remedy in which such non-taxpaying entities, which are interested parties and have stated a claim with respect to an assessment, could participate as parties. (Such a remedy might be particularly appropriate where the state is applying the unitary assessment method to a domestic subsidiary and its foreign parent, and where the state is demanding the business records of the foreign parent).

In addition, the problem of circumvention of state procedures and of simultaneous litigations can be minimized by the district court in many cases. For example, where appropriate, the district court has authority to stay a federal proceeding brought by an interested non-taxpayer, pending a determination of state administrative and judicial proceedings brought by the taxpayer. The district court also may dispose of actions brought by non-taxpayers, either before or after such a stay, where the non-taxpayer lacks standing, is not a real-party-in interest, or has failed to state a claim upon which relief can be granted. *See* note 31 *supra*.

We express no opinion as to whether a stay of Case No. 80-4114 is appropriate in the present circumstances. That determination is left for the Board Members to raise, if they desire, and the district court to consider in the first instance on remand. Among the factors the district court should consider in determining whether to stay such an action, is what imminent harm, if any, that EMI would suffer as a result of such a stay.

The Eleventh Amendment bars federal courts from hearing suits "commenced or prosecuted against one of the United States. Appellees contend that EMI's action can only be brought in federal court if the state has waived its Eleventh Amendment immunity to such an action. This argument, however, presupposes that the Eleventh Amendment would otherwise bar that action.

EMI filed its action against state officials, members of the FTB. The Eleventh Amendment does not bar federal court actions against state officials to enjoin them from enforcing unconstitutional statutes. *Ex Parte Young*, 209 U.S. 123, 28 S.Ct. 441, 52 L.Ed. 714 (1908) (injunctive action against state attorney general restraining him from enforcing state railroad rate and penalty statute). A suit against state officials is not considered a suit against the state in violation of the Eleventh Amendment where the challenged actions of the officials (1) are beyond the authority granted to them by a valid statute or (2) are performed pursuant to an unconstitutional statute. In both situations, relief can be granted without interpleading the state. *See Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 689-90, 69 S.Ct. 1457, 93 L.Ed. 1628 (1949); *see, e.g., United States Steel Corp. v. Multistate Tax Commission*, 367 F.Supp. 107, 115 (S.D.N.Y.1973), *aff'd*, 434 U.S. 452, 98 S.Ct. 799, 54 L.Ed.2d 682 (1978).

The Board Members are charged with acting unconstitutionally by applying the unitary tax method to a domestic subsidiary and its foreign parent. This case falls squarely within the doctrine of *Ex Parte Young*. In such cases, the Eleventh Amendment does not preclude access to the federal courts.

The state, however, will be deemed the real party in interest, for Eleventh Amendment purposes, if a money judgment is sought against defendants, which will have to be paid out of the state treasury. *See Edelman v. Jordan*, 415 U.S. 651, 94 S.Ct. 1347, 39 L.Ed.2d 662 (1974); *Hutchinson v. Lake Oswego School District No. 7*, 519 F.2d 961, 966 (9th Cir. 1975), *vacated on other grounds*, 429 U.S. 1033, 97 S.Ct. 725, 50 L.Ed.2d 744 (1977). Thus, a suit seeking a refund of taxes paid to a state is barred by the Eleventh Amendment even when nominally against state officials. *Ford Motor Co. v. Dept. of Treasury*, 323 U.S. 459, 65 S.Ct. 347, 89 L.Ed. 389 (1945); *Rutledge v. Arizona Board of Regents*, 660 F.2d 1345 at 1349 slip op. 5591 at 5596 (9th Cir. 1981). Although the present action might result in California receiving less tax revenue, EMI seeks prospective injunctive and declaratory relief against state officials, and not a money judgment against the state. Therefore, the Eleventh Amendment is not a bar to EMI's action in federal court.[33] *Cf. Great Northern Life Insurance Co. v. Read*, 322 U.S. 47, 64 S.Ct. 873, 88 L.Ed. 1121 (1944) (action against state tax collectors to recover monies wrongfully collected, enforceable by personal judgment); *United States Steel Corp.*, 367 F.Supp. 107 (action to enjoin application by state officials of tax law).[34]

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[33]In *Alabama v. Pugh*, 438 U.S. 781, 98 S.Ct. 3057, 57 L.Ed.2d 1114 (1978), the Supreme Court ordered summary dismissal, on Eleventh Amendment grounds, of a mandatory injunction issued against the State of Alabama and the Alabama Board of Corrections, while leaving the injunction intact against officials of the state and board.

[34]The Board Members argue that if Section 1341 or the Eleventh Amendment is not a bar to Case No. 80-4114, the federal courts should abstain from ruling on the issues presented by EMI. The Board Members rely substantially on *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 96 S.Ct. 1236, 47

VI

The order granting summary judgment in Case No. 80-4113 is vacated and the case is remanded with directions to enter an order of dismissal on grounds of lack of subject matter jurisdiction.

The order granting summary judgment in Case No. 80-4114 is reversed and remanded.[35]

L.Ed.2d 483 (1976) (abstention is appropriate where federal jurisdiction is invoked for purposes of restraining the collection of state taxes.

There is little doubt that the California courts will uphold the unitary tax scheme generally as authorized by state statute. *See, e.g., Edison California Stores, Inc. v. McColgan*, 30 Cal.2d 472, 183 P.2d 16 (1974). It is unclear, however, whether the California courts would uphold the application of the unitary method in the present case. *Compare Chase Brass and Copper Co. v. Franchise Tax Board*, 10 Cal.App.3d 496, 95 Cal.Rptr. 805 (1970) (application of unitary method to foreign operations overruled) *with Firestone Tire & Rubber Co. v. Franchise Tax Board*, Los Angeles Superior Court (No. 31243 1980) (application of unitary tax method to foreign operations upheld).

It may be desirable to allow the state courts to rule on the applicability of its unitary method in this case before the federal courts consider the constitutional issues presented. In view of this Court's ruling that EMI does not have an adequate remedy in state court, however, it would be inappropriate to dismiss Case No. 80-4114 on abstention grounds. Nevertheless, the considerations relevant to the abstention argument may also be relevant to the issue of whether Case No. 80-4114 should be stayed pending a determination of Capitol's claims in state court.

[35]Subsequent to oral argument on appeal, Capitol and EMI moved to stay the proposed assessment, pursuant to Fed.R.App.P. 27(b), pending a final determination of these cases by this Court or by the district court on remand. In view of our ruling with respect to Case No. 80-4113, the motion to stay is moot as to that case. Whether the proposed assessment should be stayed with respect to Case No. 80-4114, should be considered in the first instance by the district court on remand. *See* note 32 *supra*. Therefore, appellants' motion to stay the proposed assessment is denied. We express no opinion, however, as to whether the district court should grant such a stay.

Appendix B

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

CAPITOL INDUSTRIES-EMI, LIMITED
Plaintiff,

vs.

WILLIAM M. BENNETT, et al.,
Defendants.

EMI LIMITED,
Plaintiff,

vs.

WILLIAM M. BENNETT, et al.,
Defendants.

Nos. C-79-2145-CBR, C-79-2146-CBR

ORDER GRANTING SUMMARY JUDGMENT

[Filed Feb. 4, 1980]

These two related cases were consolidated for the purpose of hearing cross motions for summary judgment. Plaintiff in Case No. C-79-2145-CBR, Capitol Industries-EMI, Limited ("Capitol Industries"), is a Delaware corporation with its principal place of business in California. It is the sole stockholder of Capitol Records, Inc. In the second case, No. C-79-2146-CBR, plaintiff is EMI Limited, the parent of Capitol Industries and a United Kingdom corporation which has many foreign subsidiaries and no permanent establishment in the United States. Defendants in each case are members of and the chief executive officer of the California Franchise Tax Board. At issue are the

efforts of the California Franchise Tax Board to assess additional taxes on Capitol Industries based upon application of California's unitary tax, Cal.Rev. & Tax.Code §§ 25101 *et seq.*, to the operations of Capital Industries parent, EMI Limited, and its other foreign subsidiaries.

The motions for summary judgment were extensively briefed and very well argued by counsel for both parties. Indeed, the Court is most appreciative of the time and effort given by counsel to this complex matter and the gracious attempts they made to educate the Court in the complexity of the unitary tax.

While the Court has substantial question as to the ultimate constitutionality of the California unitary tax being applied to foreign corporations with foreign subsidiaries, particularly in light of *Japan Lines, Ltd. v. County of Los Angeles,* ..... U.S. ....., 60 L.Ed.2d 336 (April 30, 1979), this does not entitle plaintiffs to the injunctive relief they seek. Even assuming the unconstitutionality of such a tax, the California statutes afford the taxpayer in this case, Capitol Industries, an opportunity to have any mistake rectified. A taxpayer which believes that it has been illegally overassessed may protest the additional assessment, Cal.Rev. & Tax.Code § 25664. If the protest is denied, the taxpayer may file an appeal with the State Board of Equalization, Cal.Rev. & Tax.Code § 25667. Finally, the taxpayer may bring an action against the Franchise Tax Board for a refund, Cal.Rev. & Tax.Code § 26102. Under these circumstances, there exists a plain, speedy, efficient state remedy which precludes intervention by the federal court. *Aronoff v. Franchise Tax Board,* 348 F.2d 9, 11 (9 Cir. 1965). The parent, EMI Limited, argued that it had no such remedy, since it had no standing before the state administrative

agencies or in the state courts. However, its interest in opposing the assessment based upon the unitary tax is identical or substantially identical to that of Capitol Industries, which does have access to state administrative agencies and state courts. Under these circumstances, the Court finds that their interests being identical, EMI Limited has in effect a plain, speedy, and efficient state remedy as to the matters of which it complains. Accordingly, the Court finds that plaintiffs have failed to exhaust their state remedies and on that ground will grant defendants' motion for summary judgment.

IT IS HEREBY ORDERED that plaintiff's motions for summary judgment are denied and defendants' motions for summary judgment are granted.

IT IS HEREBY FURTHER ORDERED that counsel for defendants shall prepare an appropriate form of judgment in accordance with this order and submit it to the Court for execution within ten (10) days.

Dated: February 4, 1980.

/s/ CHARLES B. RENFREW
Charles B. Renfrew
United States District Judge

Appendix C

Judicial Code Sections.

Section 1331.

(a) The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and arises under the Constitution, laws, or treaties of the United States, except that no such sum or value shall be required in any such action brought against the United States, any agency thereof, or any officer or employee therof in his official capacity.

Section 1341.

The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy, and efficient remedy may be had in the courts of such State.

Section 2202.

In a case of actual controversy within its jurisdiction, except with respect to Federal taxes other than actions brought under section 7428 of the Internal Revenue Code of 1954 [26 USC § 7428], any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

Appendix D

United States Constitution:

Article I, § 8, Cl. 3.

Power of Congress to regulate Commerce.

To regulate commerce with foreign nations, and among the several States, and with the Indian tribes.

Art I, Section 10, Cl 1

No State shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money; emit bills of credit; make anything but gold and silver coin a tender in payment of debts; pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts, or grant any title of nobility.

Art I, Sec. 10, Cl 2

No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Control of the Congress.

Art I, Sec. 10, Cl 3

No State shall, without the Consent of Congress, lay any Duty of Tonnage, keep Troops, or Ships of War in time of Peace, enter into any Agreement or Compact with another State, or with a foreign Power, or engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay.

Sec. 2, Cl. 2. Treaties

He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur; and he shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consult, Judges of the Supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Court of Law, or in the Heads of Departments.

Art I, Sec. 8, Cl. 1

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the Common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

Art I, Sec. 8, Cl 10

To define and punish Piracies and Felonies committed on the High Seas, and Offenses against the Law of Nations.

Art III, Sec. 2, Cl 1

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority, —to all Cases affecting Ambassadors, other public Ministers and Consuls; —to all Cases of admiralty and maritime Jurisdiction; —to Controversies to which the United States shall be a Party; —to Controversies between two or more States; —between a State and Citizens of another State; —between citizens of different

States, —between citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

Art VI, Cl. 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Amendment 14 Sec. 1

. . . nor shall any State deprive any person of life, liberty, or property, without due process of law

Appendix E

Relevant Sections, United States-United Kingdom Income Tax Convention of 1946.

Article I.

(1) The taxes which are the subject of the present Convention are:

(a) In the case of the United States of America: the Federal income taxes, including surtaxes (hereinafter referred to as 'United States tax');

(b) In the case of the United Kingdom of Great Britain and Northern Ireland: The income tax (including surtax), the corporation tax, and the capital gains tax (hereinafter referred to as 'United Kingdom tax').

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Party subsequent to the date of signature of the present Convention by the government of any territory to which the present Convention is extended under Article XXII."

Article II.

(1) In the present Convention, unless the context otherwise requires:

(a) The term "United States means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and of Hawaii and the District of Columbia.

(b) The term "United Kingdom" means Great Britain and Northern Ireland, excluding the Channel Islands and the Isle of Man.

(c) The terms "territory of one of the Contracting Parties" and "territory of the other Contracting Party" mean the United States or the United Kingdom as the context requires.

(d) The term "United States corporation" means a corporation, association or other like entity created or organized in or under the laws of the United States.

(e) The term "United Kingdom corporation" means any kind of juridicial person created under the laws of the United Kingdom.

(f) The terms "corporation of one Contracting Party" and "corporation of the other Contracting Party" mean a United States corporation or a United Kingdom corporation as the context requires.

(g) The term "resident of the United Kingdom" means any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States tax. A corporation is to be regarded as resident in the United Kingdom if its business is managed and controlled in the United Kingdom.

(h) The term "resident of the United States" means any individual who is resident in the United States for the purpose of United States tax and not resident in the United Kingdom for the purposes of United Kingdom tax, and any United States corporation and any partnership created or organized in or under the laws of the United States, being a corporation or partnership which is not resident in the United Kingdom for the purposes of United Kingdom tax.

(i) The term "United Kingdom enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United Kingdom.

(j) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United States.

(k) The terms "enterprise of one of the Contracting Parties" and "enterprise of the other Contracting Party" mean a United States enterprise or a United Kingdom enterprise, as the context requires.

(l) The term "permanent establishment" when used with respect to an enterprise of one of the contracting Parties means a branch, management, factory or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the Contracting Parties shall not be deemed to have a permanent establishment in the territory of the other Contracting Party merely because it carries on business dealings in the territory of such other Contracting Party through a *bona fide* commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting Parties maintains in the territory of the other Contracting Party a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one Contracting Party has a subsidiary corporation which

is a corporation of the other Contracting Party or which is engaged in trade or business in the territory of such other Contracting Party (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

• • •

Article III.

(1) Industrial or commercial profits of an enterprise of one of the Contracting Parties shall be exempt from tax by the other Party unless the enterprise is engaged in trade or business in the territory of such other Party through a permanent establishment situated therein. If such enterprise is so engaged, tax may be imposed by such Party on the industrial or commercial profits of the enterprise but only on so much of them as are directly or indirectly attributable to the permanent establishment.

(2) Where an enterprise of one of the Contracting Parties is engaged in trade or business in the territory of the other Contracting Party through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment.

• • •

Appendix F

Title 15;

§ 381.

(a) No state, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act [Sept. 14, 1959], a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) The provisions of subsection (a) shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to:

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) For purposes of subsection (a), a person shall not be considered to have engaged in any business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, or tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office of such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, or tangible personal property.

(d) For purposes of this section:

(1) The term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

Appendix G

(Appendix C to Letter of Transmittal of the Third Protocol to the Senate on April 12, 1979)

[43] APPENDIX C

WRITTEN RESPONSES BY WITNESSES TO QUESTIONS BY SENATORS AND COMMITTEE STAFF

Department of The Treasury
Washington, D.C.
June 8, 1979.

HON. FRANK CHURCH
Chairman,
Committee on Foreign Relations,
U.S. Senate
Washington, D.C.

DEAR MR. CHAIRMAN: To follow-up my testimony at the June 6 hearings concerning the six tax conventions or protocols involving the United Kingdom, France, Hungary and Korea, I want to assure you that Article I of the Third Protocol of the proposed US-UK Income Tax Treaty gives full effect to the Senate's reservation on Article 9(4) of that treaty. Let me also assure you that there is no similar state tax issue in any of the other five treaties which were considered by the Committee yesterday.

Again, let me emphasize our view that each of these treaties is important to the United States and that their prompt approval is desirable.

I am also enclosing answers to the written questions submitted to me by your staff at the hearings as well as copies of my answers to questions from Senator Helms and Senator Javits.

Sincerely,

DONALD C. LUBICK,
Assistant Secretary
(Tax Policy).

Enclosures.

QUESTIONS FOR ASSISTANT SECRETARY FOR TAX POLICY DONALD C. LUBICK

• • • • •

[45] Questions 6 and 7. In the third protocol proposed to the U.S.-U.K. Income Tax Treaty, the definition of permanent establishment has been changed. Please explain the basis of this change. Were the affected U.S. drilling companies contacted concerning the proposed change? If they were contacted, please give the details of when, by whom, and what resulted from such contact. Why was the permanent establishment definition selected as the item to be changed in the tax area?

Answer. In our discussions with the British subsequent to the Senate reservation on Article 9(4) of the proposed treaty, the United Kingdom specifically requested the inclusion in the protocol of a provision clarifying their taxing rights with respect to exploration and exploitation connection activities. This requested clarification was not unusual in light of the original negotiations in 1975 over the perma[46]nent establishment definition. In those negotiations, the United States agreed to delete from the twelve month permanent establishment exclusion contained in subparagraph (2)(f) of the proposed treaty any refer-

ence to "an installation of drilling rig or ship used or the exploration or development of natural resources" as a result of the British insistence that there be no limitation on their right to tax such activities. This deletion left the application of the permanent establishment definition to these activities somewhat uncertain, although as the United Kingdom authorities believe, a strong argument exists, that these activities could be taxed even without the clarification of the new protocol.

We agreed to the inclusion of this provision in the Third Protocol because it was reasonable to expect the British to request some additional concession for loss of the benefits of Article 9(4); because the terms of the provision were reasonable in light of our own statutory tax policy (we would generally tax these kinds of activities conducted in the United States, even if they were of a shorter duration than 30 days); and because it could be viewed as little more than a clarification of a reasonable interpretation taken by the British of their taxing rights under the proposed treaty without the protocol provision.

The drilling industry was clearly aware of the precise terms of the protocol provision at least one month prior to the signing of the Protocol on March 15, 1979. On February 16, 1979, Mr. Arnold W. Bramlett, Chairman of the Accounting and Taxation Committee of the International Association of Drilling Contractors (IADC), wrote to the International Tax Counsel, Mr. H. David Rosenbloom, expressing general concern over the provision. Subsequently, there were telephone conversations between Mr. Rosenbloom and Mr. Bramlett in which the Treasury sought specific information as to the nature of the activities and the harm which was alleged would occur. These requests

were confirmed in a letter from Mr. Rosenbloom to Mr. Bramlett on March 5, 1979, still 10 days before the Protocol was signed. To date, the Treasury has not received from the IADC, or any of its members, specific information detailing any specific adverse effects of the protocol provision.

THIRD PROTOCOL TO THE U.S.-U.K. INCOME TAX TREATY:

Question 1. Would you please summarize the British reaction to the reservation included in the Senate advice and consent to ratification last June 27, 1978, concerning Article 9(4).

Answer. The British tax authorities were unhappy with the Senate reservation concerning Article 9(4). They hoped that a modified version of Article 9(4) might be included in the treaty. When it became clear that there was no possibility of a modification which would be acceptable to all parties, they reluctantly agreed to seek Parliamentary approval of the treaty with the deletion of Article 9(4) but only after the Third Protocol is approved by the Senate. The British authorities view some of the provisions of the Third Protocol (particularly the North Sea permanent establishment rules) as a concession for the deletion of Article 9(4). We recently reconfirmed with the British their willingness to go forward with the treaty if the protocol is approved by the Senate.

[47] Very strong objection has been raised by the United Kingdom business community to the deletion of Article 9(4). Many business and industrial groups in the United Kingdom have urged Parliament not to reapprove the treaty in the absence of the Article 9(4) provision.

The strength of these objections was confirmed by testimony at the June 6 hearings to the effect that there is a view among some Conservative Members of Parliament that the treaty should not be approved unless some solution can be found to the state taxation problem, albeit outside the treaty framework.

Question 2. Would any reservations added at this date jeopardize the Third Protocol and/or the US/UK Income Tax Treaty? If yes, please explain.

Answer. In our judgment any reservation on the Third Protocol, or any substantial delay in approval of the Protocol will seriously jeopardize the chances that the proposed US/UK Income Tax Treaty, with its very substantial benefits for U.S. taxpayers, will ever come into effect.

While we cannot speak for the United Kingdom, or predict with absolute certainty the actions which might be taken by the British Parliament, certain facts are clear. There is strong business opposition in the United Kingdom to the treaty reservation on Article 9(4) and as time passes there is also likely concern over the growing cost of the retroactive refund to the U.S. investors of the British Advance Corporation tax (it will be over $500 million through 1979). Despite this, the British have agreed to go forward to Parliament with the treaty as long as the U.S. Senate approves the Third Protocol containing what we, and they, view as a reasonable and justifiable provision clarifying the United Kingdom's taxing rights over certain offshore activities.

Should the United States again reserve on a treaty provision important to the British, particularly one which is reasonable in light of both the domestic tax law of the

United States and the history of the basic treaty, it may well provide sufficient impetus for those in the United Kingdom opposed to the treaty to secure its defeat. Prolonged delay could have a similar effect.

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CLERK

No. 82-688

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1982

CAPITOL INDUSTRIES-EMI, INC.,
Petitioner,

VS.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., Successor; KENNETH CORY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor,
Respondents.

On Petition for Writ of Certiorari To the United States Court of Appeals for the Ninth Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether 28 United States Code section 1341, in any event, bars this action.

2. Whether the Eleventh Amendment to the United States Constitution bars this action.

3. Whether the anti-injunction provisions of the California Constitution and statutes bar this action.

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No. 82-688

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OCTOBER TERM, 1982

CAPITOL INDUSTRIES-EMI, INC.,
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VS.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., Successor; KENNETH CORY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor,
Respondents.

On Petition for Writ of Certiorari
To the United States Court of Appeals
for the Ninth Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

I

JURISDICTION

The technical jurisdictional requirements appear to be set forth adequately in the petition. It should be observed that petitioner's contentions were rejected by the United States Court of Appeals, Ninth Circuit, based upon and in conformity with the pertinent decisions of this Court and the California courts. Moreover, petitioner's petition represents nothing more than a blatant attempt by petitioner, a corporation doing business in California, to circumvent well-established procedures for contesting taxes assessed against it by the Franchise Tax Board (hereafter "FTB") of the State of California.

II

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

1. Eleventh Amendment to the United States Constitution.

2. Section 1341, title 18, United States Code.

3. California Constitution, article XIII, section 32.

4. California Revenue and Taxation Code sections 26101, 25101, 25128 and 25137.

III

STATEMENT OF THE CASE

Prefatory Statement

As petitioner had done previously in its petition for certiorari while this case was still pending in the Court of Appeals, Ninth Circuit,[1] it has egregiously misstated a cru-

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[1]Filed on December 18, 1981, in this Court under No. 81-1177.

cial fact in the opening statement of its "Statement of the Case," when it states that defendant tax officials seek to assess a tax against petitioner on a portion of the income of its parent and 71 non-United States subsidiaries. (Petn. for Cert., p. 3.) First, the proposed assessment was made by the FTB of the State of California and not by any of the named defendants. Second, the proposed assessment was an assessment against petitioner based on the unitary method of taxation and *not an assessment on a portion of the income of petitioner's parent or related corporations.*

In addition, petitioner has failed to mention or discuss the cases of *Fair Assessment In Real Estate Association, Inc. v. McNary* (1981) ..... U.S. ....., 70 L.Ed.2d 271, and *California et al. v. Grace Brethren Church* (1982) ..... U.S. ....., 73 L.Ed.2d 93. Both of these cases expressly sustained the long-established principle of federal-state relationship that the federal judiciary should not interfere in state tax matters.

The above-mentioned misstatement of fact and omission of two recent landmark cases of this Court vividly demonstrate the total lack of merit in petitioner's petition.

1. Statement of the Case

In this matter, on August 15, 1979, petitioner Capitol Industries-EMI, Inc. (hereafter "Capitol") filed an action for injunctive and declaratory relief against the named defendants to prevent the FTB from assessing additional taxes against Capitol on the unitary tax method. The trial court granted summary judgment to the respondents on the grounds that Capitol had a "plain, speedy, and efficient state remedy" in the state court.

Capitol then appealed the decision to the Court of Appeals, Ninth Circuit, which also held that Capitol had a plain, speedy and efficient remedy before the state administrative agency and court, and remanded the case for dismissal.

2. Facts of the Case

The only facts which are essential to resolve this appeal are as follows:

a. Capitol is a United States corporation doing extensive business in California and elsewhere.

b. EMI Limited (hereafter "EMI") is a United Kingdom corporation, which holds over 70 percent of the outstanding shares of Capitol.

c. Capitol is a California taxpayer.

d. FTB has proposed to assess additional taxes against Capitol for the years 1968 through 1974 on the unitary method.

e. Under the unitary method, which has been upheld time and time again by the California and United States Supreme Courts, the incomes of all companies which are determined to be engaged in a unitary business are combined and apportioned according to a formula.[2] *(Butler Bros.*

---

[2]California Revenue and Taxation Code section 25101 provides in part:

> "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of article 2 (commencing with section 25120 of this chapter)...."

v. McColgan (1942) 315 U.S. 501, affirming 17 Cal.2d 664; *Edison California Stores, Inc. v. McColgan* (1947) 30 Cal. 2d 472; *Superior Oil Co. v. Franchise Tax Board* (1963) 60 Cal.2d 406 and *Chase Brass & Copper Co. v. Franchise Tax Board* (1970) 10 Cal.App.3d 496.)

f. Under the California method, the following formula is generally used to compute an individual taxpayer's California source income:

Taxpayer's property in California / Combined group's total property everywhere	= %
Taxpayer's payroll in California / Combined group's total payroll everywhere	= %
Taxpayer's sales in California / Combined group's total sales everywhere	= %
Total of Three Percentages	= %

Total of Three Percentage ÷ 3 = Average Percentage

Average Percentage × Total Combined Income = Taxpayer's California Source Income[3]

g. In this case, FTB included the combined incomes of Capitol and EMI in determining Capitol's California source income. The resulting tax deficiency was then imposed against Capitol. (Par. V of Capitol's Complaint.)

h. Capitol filed a protest with FTB with respect to the proposed additional assessment. Thereafter the FTB made an adjustment and issued a revised assessment against Capitol.

---

[3]California Revenue and Taxation Code section 25128 provides:

"All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three."

California Revenue and Taxation Code sections 25129 through 25136 define and provide for the computation of the property, payroll and sales factors.

i. Capitol filed a petition with the FTB under California Revenue and Taxation Code section 25137[4] for authorization to use another method of reporting the tax. The FTB denied Capitol's petition for relief under Revenue and Taxation Code section 25137 on October 1, 1981.

j. Capitol then filed an appeal with the California State Board of Equalization, where the matter is presently pending.

k. Capitol has not sought any relief before the California state courts.

l. Capitol has not paid the tax because its state administrative appeal is still pending.

---

[4]Revenue and Taxation Code section 25137 provides as follows:

"If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

"a. Separate accounting;

"b. The exclusion of any one or more of the factors;

"c. The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

"d. The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

ARGUMENT

I

THE COURT PROPERLY ORDERED DISMISSAL OF THE ACTION BECAUSE THE COURT LACKED JURISDICTION

A. 28 United States Code Section 1341 Bars the Federal District Courts from Hearing a Case Such as the Instant One

The historic rule that the federal courts will not interfere with the internal fiscal operations of the states has been codified in 28 United States Code section 1341:

> "The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

It is well established that 28 United States Code section 1341 is an explicit congressional limitation on the jurisdiction of the federal courts in cases which would enjoin, suspend or restrain state tax levy, assessment or collection. (*Randall v. Franchise Tax Board of the State of California* (9th Cir. 1971) 453 F.2d 381, 382; *Bland v. McHann* (5th Cir. 1972) 463 F.2d 21, 24, cert. denied, (1973) 410 U.S. 966.) Furthermore, neither the judicial decisions nor section 1341 require that the state remedy be the best remedy available or even equal to or better than the remedy which might be available in the federal courts. *(Id.)*

During the past term, this Court has unequivocally reaffirmed this principle in two different cases so as to remove any doubts as to its breadth and scope. Apparently petitioner has not read those decisions as evidenced by the absence of any reference to them in its instant petition.

The first case of note is *Fair Assessment In Real Estate v. McNary, supra,* ..... U.S. ....., 70 L.Ed.2d 271, where this Court held that under the principle of comity taxpayers cannot assert section 1983 actions against the validity of state tax systems in federal courts prior to the exhaustion of state remedies.

In *Fair Assessment,* plaintiff property owners brought suit against various county officials for damages under the Civil Rights Act. (42 U.S.C. § 1983.) In their complaint, the plaintiffs alleged principally that:

> (1) Properties with new improvements were assessed at 33½ percent of current market value while those without improvements were assessed at 22 percent of current market value; and
>
> (2) Property owners who successfully challenged assessments against their properties were assessed at a higher rate the following year.

This Court sustained the trial court's decision barring plaintiffs' action on the grounds of comity and the proscriptions of the Anti-Injunction Act. In its decision this Court reviewed the legislative history of the Anti-Injunction Act and the long-established principle of comity in the federal courts and said:

> "This case is therefore controlled by principles articulated even before the enactment of § 1983 and followed in later decisions such as *Matthews* and *Great Lakes.* The recovery of damages under the Civil Rights Act first requires a 'declaration' or determination of the unconstitutionality of a state tax scheme that would halt its operation. And damage actions, no less than actions for an injunction, would hale state officers into federal court every time a taxpayer alleged the requisites of a § 1983 claim. We consider such interference to be contrary to 'the scrupulous regard for the right-

> ful independence of state governments which should at all times actuate the federal courts.' Matthews, 284 U.S. at 525." (*Id.*, at p. 283.)

This Court then concluded that plaintiffs first must exhaust all state remedies, including those pertaining to section 1983 if a state has such a remedy.

In short, this Court again held that taxpayers must exhaust all state remedies before going to the federal courts.

The second important decision reaffirming the integrity of the Anti-Injunction Act is *California et al. v. Grace Brethren Church, et al., supra,* ..... U.S. ....., 73 L.Ed.2d 93. In that case, a Federal District Court in California held that Federal Unemployment Tax Act section 3309(b)(1) (26 U.S.C. § 3309(b)(1)) and California Unemployment Insurance Code section 634.5(a) were unconstitutional as interpreted and applied. The District Court had concluded that the application of said statutes results in excessive entanglement of the state with religion in the benefit eligibility determination process with the respect to employees of independent religious schools and, therefore, the employers of said employees are not required to participate in the federal-state unemployment compensation tax program.

This Court then vacated the District Court's judgment and remanded the case on the basis that 28 United States Code section 1341 barred this action by the religious schools in which they were seeking exemption from unemployment taxes on religious grounds. The court reasoned that the religious schools had a plain, speedy and efficient remedy in state court through the suit for refund procedures.

In the course of the *Grace Brethren* decision, this Court noted several important points:

> (1) That a state court remedy is plain, speedy and efficient if it provides the taxpayer with a full hearing and judicial determination at which he may raise any and all constitutional objections to the tax. (..... U.S. ....., 73 L.Ed.2d 108.)
>
> (2) That Congress and the federal courts have both expressed in their own way the long-established policy of not interfering with the operation of state tax systems if the taxpayer had an available remedy in the state courts. (..... U.S. ....., 73 L.Ed.2d 109.)
>
> (3) That the California Unemployment Insurance Code provides a plain, speedy and efficient remedy to the taxpayer. (..... U.S. ....., 73 L.Ed.2d 110-112.)

In this case, the Court of Appeal held that Capitol has speedy, efficient and proper remedies before the state administrative and judicial machinery, and that its proper, speedy and efficient remedy is to have Capitol pay the tax, if any is ultimately assessed,[8] and then pursue an action in the state courts.

The California Revenue and Taxation Code provisions referred to below provide readily available and wholly effective administrative procedures for aggrieved taxpayers. Once these administrative remedies have been exhausted, the taxpayer can institute an action for a refund in the state court. This procedure has been consistently held, as a matter of law and without a single instance of deviation, to be plain, speedy and efficient as to invoke the restraints of

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[8]Because Capitol has not yet exhausted its administrative remedies, the entire lawsuit may become moot if Capitol prevails at the administrative level.

28 United States Code section 1341. (*Nevada-California Electric Corp. v. Corbett, supra,* 22 F.Supp. 951; *Corbett v. Printers and Publishers Corp., Ltd., supra,* 127 F.2d 195, 197.) Moreover, a taxpayer can further expedite the state administrative procedures by paying the tax, filing a claim for refund and wait for six months, and then filing a suit for refund in the state court. (Rev. & Tax. Code, §§ 26073, 26074, 26075 and 26076.) Since Capitol has not exhausted its available state administrative and judicial remedies, the action should be dismissed for lack of jurisdiction. (*Bland v. McHann, supra,* 463 F.2d 21, cert. den., 410 U.S. 966.)

Finally, in its misguided effort to support an untenable position, Capitol has been forced to rely on a group of cases which are completely inapposite. For example, *Hillsborough v. Cromwell* (1946) 326 U.S. 620, involved a New Jersey statute where the taxpayer's state remedies were not certain. In fact the taxpayer's right of review of constitutional questions by the New Jersey judiciary was dependent on the discretionary grant of certiorari by the New Jersey Supreme Court. Capitol certainly cannot be contending that California provides only discretionary judicial review. If it is so contending, it is absolutely wrong because all taxpayers have the absolute right of judicial review of all issues by way of a suit for refund. The California and federal courts have consistently held that the suit for refund procedure furnishes the taxpayer with a plain, speedy and efficient remedy. (*Aronoff v. Franchise Tax Board* (1965) 348 F.2d 9; *Greene v. Franchise Tax Board* (1972) 27 Cal.App.3d 38; *Casey v. Bonelli* (1949) 93 Cal.App.2d 253; and *Modern Barber Col., Inc. v. California Emp. Stab. Com.* (1948) 31 Cal.2d 720.)

Then Capitol goes on to completely mischaracterize the holding of *West Publishing Co. v. McColgan* (1946) 27 Cal.

2d 705, affirmed, 328 U.S. 823. In *West Publishing*, the court was not called upon to decide the question of whether the taxpayer could present before the trial court evidence which it had not previously presented to the administrative agency. *In fact, the plaintiff in West Publishing had flatly refused to file a tax return.* It is difficult to believe that Capitol would rely so heavily on *West Publishing* and then twist its fact in a futile effort to draw a parallel with the facts in this case. Moreover, Capitol is well aware of the fact that in California all tax refund cases are tried de novo,[6] where the plaintiff is not limited to introducing before the court only such evidence as was previously presented to the administrative agency.

Then in what is clearly a desperate effort to gain this Court's attention, Capitol has misstated the facts and holding of the case of *Barnes v. State Board of Equalization* (1981) 118 Cal.App.3d 994. *Barnes* clearly and simply held that if a person willfully refuses to present any facts or data to the administrative agency to support his claim for refund, he cannot file a suit for refund because he has failed to exhaust his administrative remedies.[7] Any person

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[6]Capitol Records was a plaintiff in a sales tax refund case in California entitled *Capitol Records, Inc. v. State Board of Equalization*, Sacramento Superior Court No. 255286, where it engaged in extensive pretrial discovery proceedings.

[7]The facts set forth in the *Barnes* decision will show that *Barnes* was not a taxpayer; he was not registered with the State Board of Equalization; and he had never paid any taxes to the State Board of Equalization. Thus, when Barnes filed a claim for refund raising both factual and legal issues, the Board requested Barnes to provide support for his contentions. Barnes refused to furnish any support. As a result the Board denied the claim for refund. Barnes then filed a suit for refund although he had refused to supply the Board with any information, including the exact amounts and dates of alleged payment of taxes.

who reads *Barnes* would readily see that any attempt to analogize *Barnes* with this case is utterly meritless. Thus, petitioner's extensive speculation and conjecture as to what the California courts at all levels might do on account of *Barnes* is so absurd that comment is not necessary.

B. The Eleventh Amendment to the United States Constitution Deprives this Court of Jurisdiction in this Action and Mandates a Dismissal

Unchanged since its adoption in 1798, the Eleventh Amendment to the United States Constitution provides as follows:

> "The judicial power of the United States shall not be construed to extend to any suit in law or equity, commercial or prosecuted against one of the United States by citizens of another State, or citizens or subjects of any foreign State."

The United States Supreme Court has consistently held that an unconsenting state is immune from suits brought in federal court by her own citizens as well as by citizens of another state. (*Hans v. Louisiana* (1890) 134 U.S. 1; *Duhane v. New Jersey* (1920) 251 U.S. 311; *Great Northern Life Insurance Co. v. Read* (1944) 322 U.S. 47; *Parden v. Terminal R. Co.* (1964) 377 U.S. 184; *Employees v. Dept. of Public Health and Welfare* (1973) 411 U.S. 279.) It is also well established that even though a state is not named a party to the action, the suit may nonetheless be barred by the Eleventh Amendment. In *Ford Motor Co. v. Dept. of Treasury* (1945) 323 U.S. 459, the Supreme Court said:

> "[W]hen the action is in essence one for the recovery of money from the state, the state is the real, substantial party in interest and is entitled to invoke its sovereign immunity from suit even though individuals are nominal defendants." (*Id.* at p. 464.)

Thus, the rule has evolved that a suit by private parties seeking to impose a liability which ultimately will be paid from public funds in the state treasury is barred by the Eleventh Amendment. (*Great Northern Life Insurance Co. v. Read, supra*; *Kennecott Copper Corp. v. Tax Comm'n* (1946) 327 U.S. 573.)

As Capitol alleges in its complaint, the defendants are members of the California FTB and its chief executive officer. And as Capitol further alleges in its complaint, defendants were merely carrying out their statutory duties as members of the FTB or as its chief executive officer. In such an action, while the individuals may be named as nominal defendants, the treasury of the State of California will to a virtual certainty be deprived of revenue which otherwise would normally have been collected. Absent a waiver by the State of California, the Eleventh Amendment is, therefore, a bar to Capitol's action.

In deciding whether a state has waived its constitutional protection under the Eleventh Amendment, the United States Supreme Court has held that a waiver will be found only where stated "by the most express language or by such overwhelming implications from the text as [will] leave no room for any other reasonable construction." (*Murray v. Wilson Distilling Co.* (1909) 213 U.S. 151, 171.) As stated in the court's decision in *Edelman v. Jordan* (1973) 415 U.S. 651, 673:

> "We see no reason to retreat from the Court's statement in *Great Northern Life Insurance Co. v. Read*, 322 U.S. at 54 (footnote omitted): '[W]hen we are dealing with the sovereign exemption from judicial interference in the vital field of financial administration a clear declaration of the state's intention to sub-

> mit its fiscal problems to other courts than those of its own creation must be found.'"

To the extent that the State of California administers the Bank and Corporation Tax Law (Rev. & Tax. Code, § 23001 et seq.), it clearly has not waived such immunity. To the contrary, the state has established in state courts a "plain, speedy, and efficient remedy" for determining whether taxes have been erroneously or illegally assessed or collected (Rev. & Tax. Code, § 25661 et seq.; § 26071 et seq.; § 26102; *Corbett v. Printers and Publishers Corp., Ltd., supra,* 127 F.2d 195, 197; *Nevada-California Electric Corp. v. Corbett, supra,* 22 F.Supp. 951). Capitol has, therefore, failed to meet its burden of alleging or showing that the State of California has waived its immunity from this kind of suit, or this particular suit, in federal court. (*Whitner v. Davis* (9th Cir. 1969) 410 F.2d 24, 29; *Clark v. State of Washington* (9th Cir. 1966) 366 F.2d 678, 680.)

In *Fair Assessment In Real Estate Association, Inc. v. McNary, supra,* ..... U.S. ....., 70 L.Ed.2d 271, this Court again recognized the prohibitions of the Eleventh Amendment with respect to state fiscal matters notwithstanding *Ex Parte Young* (1908) 209 U.S. 123.

> "After this Court conclusively decided that federal courts *may* enjoin state officers from enforcing an unconstitutional state law, *Ex Parte Young,* 209 U.S. 123 (1908), Congress also recognized that the autonomy and fiscal stability of the States survive best when state tax systems are not subject to scrutiny in federal courts. Thus, in 1937 Congress provided: [Text of 28 U.S.C. § 1341]." (*Fair Assessment In Real Estate Association, Inc. v. McNary, supra,* ..... U.S. ....., 70 L.Ed. 2d 271.)

II

NO INJUNCTION MAY ISSUE NOR DECLARATORY RELIEF BE GRANTED TO PREVENT OR ENJOIN THE ASSESSMENT OR COLLECTION OF TAXES

Capitol has correctly alleged in its complaint that under California law a suit for injunction, declaratory relief or other equitable process to prevent or enjoin the assessment or collection of any taxes is forbidden.

Section 32 of article XIII of the California Constitution states:

> "No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid with interest, in such manner as may be provided by the Legislature."

In like manner, Revenue and Taxation Code section 26101 relating specifically to the assessment or collection of bank and corporation taxes states:

> "No injunction or writ of mandate or other legal or equitable process shall issue in any suit, action or proceeding in any court against this State or against any officer of this State to prevent or enjoin the assessment or collection of any tax under this part."

These provisions have been continually sustained by the courts. (*Pacific Gas & Electric Co. v. St. Bd. of Equalization* (1980) 27 Cal.3d 277; *Aronoff v. Franchise Tax Board, supra,* 348 F.2d 9; *Casey v. Bonelli, supra,* 93 Cal.App.2d 253; *Modern Barber Col. Inc. v. California Emp. Stab. Com., supra,* 31 Cal.2d 720.) But Capitol's allegation does not confer federal court jurisdiction. If Capitol would pay

the tax and litigate the question in the state courts just like the rest of the California taxpayers, Capitol would not have the problem with which it is faced. Equal protection and due process do not mean preferential treatment for wealthy corporations with unlimited resources to pay for protracted but clearly untenable litigation.

III

CALIFORNIA COURTS CAN AND ARE FULLY QUALIFIED TO DECIDE THE QUESTION OF THE CONSTITUTIONALITY OF THE UNITARY METHOD OF TAXATION AS APPLIED TO CAPITOL

Even in this age of profligate lawsuits, this action by Capitol is as incredible as the one brought by EMI, Limited, Capitol's parent. This is not an action involving any basic inalienable constitutional rights of a resident or citizen of the United States. Quite to the contrary. This is an action by a wealthy corporation, brought in violation of long-established law in an effort to sidestep the state court and to use the federal courts to judicially overthrow the sovereign taxation powers of the State of California.

If California's unitary method is as unconstitutional and illegal as Capitol would have this Court believe, the California appellate and supreme courts would nullify it. After all, Capitol has not furnished any evidence that the California courts are not capable of understanding the law. Nor is there any evidence that the California courts would not follow the laws as interpreted by the United States Supreme Court.

Capitol's suit is also disruptive of the entire judicial process. There are recognized principles covering the subject of contesting state taxes. In addition, there is the proscrip-

tion against multiple lawsuits. In this day when the public is clamoring for less taxes and greater government efficiency, responsible persons should seek to minimize litigation. This lawsuit completely violates these principles. There is not one valid reason for a taxpayer such as Capitol to challenge a state tax in the federal courts when it has an adequate and speedy remedy before the California administrative agencies and courts. (*Aronoff v. Franchise Tax Board, supra,* 348 F.2d 9.) Moreover, there will be utter chaos if every disgruntled taxpayer sought to attack state laws in the federal courts under the guise of some purported violation of a constitutional provision.

CONCLUSION

For the foregoing reasons, it is respectfully submitted this petition for writ of certiorari should be denied.

Respectfully submitted,

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